November 7, 2012

Academies Australasia Group
Initiating Coverage

A tertiary education business that evolved, via progressive acquisition, out of a listed entity with over 100 years of history. AKG operates nine colleges in Australia and a tenth in Singapore, offering vocational, English and higher education. Its students have been sourced from 114 countries (currently from ~70).

You might learn a thing or two
Academies Australasia (ASX code: AKG) has built an education business via acquisition over the past 13 years. It is the only robust ASX-listed alternative to Navitas (ASX code: NVT) for those seeking exposure to the education sector.

AKG has ~4,500 students enrolled. Its current cohort is sourced from ~70 countries, with the biggest single source being Indonesia, representing 14%-15% of its students. It is also one of three Australian educators operating in Singapore (alongside Navitas and James Cook University).

Positioned as a sector consolidator
AKG’s first education acquisition in 1999 was Clarendon Business College, an operation that had over 40 years of history and offered diploma courses with a focus on business, IT, management and tourism. Several acquisitions followed that initial move before a period of consolidation.

Over the past two years AKG has bought: 75% of Academies Australasia Polytechnic, which offers its own courses and University of Ballarat programs in the Melbourne CBD; 51% of Sydney-based vocational training group Benchmark College; a 10% stake in struggling competitor RedHill Education (ASX code: RDH); 40% of Sydney-based College of Sports and Fitness; and 100% of Melbourne-based Discover English.

Separately, AKG holds a legacy fasteners business that designs, makes & imports screws. It is a non-core business that contributes to profits but ideally we think could be divested to fund Education consolidation. AKG’s board has confirmed it would consider such a sale.

An efficient operator facing a robust global market
We like the education sector’s counter-cyclical characteristics and believe it possesses some price-inelasticity as education is closely tied to aspirations. International demand for tertiary & vocational education is expected to grow strongly over the medium-term and well-run educators with good reputations should thrive in such an environment.

AKG trades at a discount to larger, established peers and has the opportunity to continue consolidation of a highly fragmented sector. We initiative coverage with a Buy rating and a current valuation of $0.88.

Rating Valuation ASX code
Buy $0.88 AKG

Pricing Data
52-w range (closing price) $0.44 - $0.80
Current price $0.800
Diluted shares (m) 47.35
Market cap ($m) 37.9
Net debt ($m) 0.3
EV ($m) 38.2

Key Financial Metrics & Forecasts

<table>
<thead>
<tr>
<th>$m</th>
<th>FY11a</th>
<th>FY12a</th>
<th>FY13f</th>
<th>FY14f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>25</td>
<td>34</td>
<td>38</td>
<td>43</td>
</tr>
<tr>
<td>EBITDA</td>
<td>3.84</td>
<td>4.92</td>
<td>5.77</td>
<td>6.78</td>
</tr>
<tr>
<td>Net profit (adj)</td>
<td>2.41</td>
<td>2.36</td>
<td>3.08</td>
<td>3.78</td>
</tr>
<tr>
<td>EPS (adj)</td>
<td>$0.055</td>
<td>$0.053</td>
<td>$0.065</td>
<td>$0.080</td>
</tr>
<tr>
<td>Dividend</td>
<td>$0.040</td>
<td>$0.045</td>
<td>$0.052</td>
<td>$0.064</td>
</tr>
<tr>
<td>EV/EBITDA</td>
<td>9.9x</td>
<td>7.8x</td>
<td>6.6x</td>
<td>5.6x</td>
</tr>
<tr>
<td>P/E (adj)</td>
<td>14.5x</td>
<td>15.1x</td>
<td>12.3x</td>
<td>10.0x</td>
</tr>
<tr>
<td>Net yield</td>
<td>5.0%</td>
<td>5.6%</td>
<td>6.5%</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

Top 20 shareholders own: 92%
Largest shareholder: Chiang Meng Heng - 53%.
Portion of shares traded last 4 weeks: 0%
Contents

Company Background

History of company 3
Shareholders, executives & directors 3

Business Segments

Education 4
Singapore 4
Fasteners 4

RedHill Education 5

Target Markets & Industry Background

Focus on international students, vocational education 6
Knight Review 7
Fragmentation 7
Industry decline not yet arrested 7
Education tied to aspiration 8
Currency issue over-played 8
Tertiary student volumes to scale up globally 10
Fasteners 10

Historical Financials 11

Earnings Forecasts 12

Valuation 13

Key Risks 15

Financials 16

Important Notices, Disclaimer 17
Investorfirst Contacts 19
Company Background

AKG has built an education business via acquisition over the past 13 years. The company, previously known as Garratt’s, has owned businesses in a number of industries over decades but made a strategic decision in to move into education and sell (in 2000) a previous operation, call recording device maker Electrodata, which it felt would struggle against international competitors.

AKG’s first education acquisition in 1999 (for $1.075m) was Clarendon Business College, an operation that had over 40 years of history and offered diploma courses with a focus on business, IT, management and tourism.

Several acquisitions followed that initial move before a period of consolidation. Over the past two years AKG has bought:

- 75% of Melbourne-based Academies Australasia Polytechnic (formerly AMI Education) for ~$1.1m, which offers tourism and hospitality qualifications as well as English courses and delivery of University of Ballarat programs, including MBAs (51% bought in February 2011 for 1.1m shares and $0.18m cash, then 24% bought in April 2011 for another 0.52m shares and $0.09m cash).
- 51% of Sydney-based vocational training operator Benchmark College for $5.5m ($3.2m cash and $2.3m scrip, announced June 2011); with expectation of maintainable EBITDA of $2.8m a year.
- A ~10% stake in struggling group Redhill Education (ASX code: RDH) built up over time.
- 40% of International College of Capoeira, trading as College of Sports and Fitness, for $0.3m cash and 0.14m shares (completed October 2012, option over additional 11%)
- 100% of Melbourne-based English language college Discover English for $0.19m (completed October 2012)

Singapore—a launching pad into Asia

In September 2009 AKG entered the Singapore market (AKG managing director Christopher Campbell started his career in Singapore) with the purchase of 75% of Washington Institute (for 750,000 AKG shares).

AKG’s management have a desire to grow their Asian presence, offering an Australian-standard education at locations closer to students’ homes and at a lower total cost to the student, widening the potential market for AKG.

Shareholders, executives & directors

AKG’s largest shareholder is its non-executive director Chiang Meng Heng, who holds a 52.8% relevant interest (including 8% owned by Eng Kim Low), followed by managing director Christopher Campbell, who holds 15.4% (including a 14.4% stake owned by Jilcy Pty Ltd).

Benchmark managing director Philip Carroll has 9% and Vasek Fasteners has 3.3%. All up, the top 20 shareholders spoke for 91.9% of issued equity as of July 31, 2012.

Key People

- Christopher Campbell: has been managing director of AKG since 1996. Previously served with the Monetary Authority of Singapore and worked as an investment banker in Australia.
- Gabriela Rodriguez: serves as general manager and chief operations officer, with a background in IT and education.
- Philip Carroll: is an executive director and managing director of Benchmark. He was previously College Coordinator of Labour Market Programmes at Western Sydney Institute of TAFE.
- Esther Teo: CEO of Academies Australasia Polytechnic. Has held senior management positions in Coles Myer and teaching appointments at RMIT, Swinburne and Monash.
- Edmund Kwan: CEO of Academies Australasia Singapore. Has held a number of management roles in education in Singapore, including director of Continuing Education for Marketing Institute of Singapore and general manager, YMCA Education Services.
- Ivan Mikkelsen: is the general manager of AKG’s Fasteners business.
- Neville Cleary: is AKG’s non-executive chairman and former Head of Lending at Commonwealth Bank (until 1992). He was on the board of listed property group Ipoh until it as acquired in 2003.
- Chiang Meng Heng: a non-executive director and the largest shareholder. Following a career in banking (including time at the Monetary Authority of Singapore) and property development, he has held a number of directorships with Singapore listings.
Business Segments

AKG is primarily focused on its Education business but retains a legacy Fasteners operation. The board would consider a divestment of Fasteners.

Education

AKG operates nine colleges in Australia (mostly in Sydney) and one in Singapore. Assisted by the series of acquisitions already noted, annual sales have grown from $2.3m in FY05 to $25.3m in FY12. EBITDA margins have ranges between 20% and 25%. This segment generated 77% of sales in 2H12 and 86% of EBITDA (before unallocated expenses).

- **Clarendon Business College**: a Registered Training Organisation (RTO) established in 1960 that specialises in Accounting & Financial Services, Business Management and Travel & Tourism.
- **Supreme Business College**: an RTO established in 1965 that specialises in Business Administration.
- **Academies Australasia Institute**: an RTO that specialises in Business Management.
- **Academies Australasia Polytechnic** (formerly AMI): 75%-owned Melbourne business that delivers English, Vocational and Higher Education studies to domestic and international students. It is a University of Ballarat Partner Provider delivering University of Ballarat’s Diploma, Advanced Diploma and Higher Education programs in Business, Commerce and Management programs.
- **Australian College of Technology**: an RTO that specialises in Information Technology and Marketing.
- **Academy of English**: Offers courses in General English for students at Elementary to Upper-Intermediate level as well as EAP/IELTS Preparation and English Preparation for High School.
- **Australian International High School**: offers the NSW Higher School Certificate (ie Years 11 & 12).
- **Benchmark College**: an RTO with a focus on domestic students offering qualifications across Business Management, Childrens Services, Health & Community Services, industry training & traineeships.
- **Discover English**: Melbourne-based English tuition

Singapore

AKG reported revenue from Singapore of $2.25m in FY12. Its Singapore college is now branded as Academies Australasia College and has secured the Singaporean Ministry of Education’s EduTrust certification (valid until April 2016), placing it in the highest classification awarded so far, alongside two other Australian-operated colleges in the city-state (James Cook and Curtin).

Fasteners

AKG acquired Premier Fasteners in 1998. This business designs, manufactures and imports fasteners that it supplies to merchants and manufacturers. It focuses on supplying non-standard or urgently-required fasteners.

Revenue from this segment has been more or less stable over many years ($7.7m in FY12 from $6.3m in FY05), although bolstered by an opportunistic acquisition in November 2011 (for $0.68m cash and $0.52m deferred). Its earnings contribution has been more volatile, with EBITDA margins declining to as low as 8% in 1H12 from 15% in 1H11.
RedHill Education (ASX code: RDH)

Sydney-based RDH operates three colleges: the Academy of Information Technology, Greenwich College (English language) and the International School of Colour and Design. It also owns an independent student agency GoStudy!

AKG and associates now own 2.93m shares in RDH, representing a ~10% stake, having progressively purchased shares over the past two years. This represents a $0.38m investment at the current share price of $0.13.

RDH was built through aggregation by private equity investor Exto Partners and sold to the public in an IPO in 2010, with prospectus forecasts that it never had any chance of achieving. In April 2012 it announced a restructure under which its three colleges were brought into a corporate structure, having previously operated semi-autonomously.

The company has stated that it is planning to increase its range of courses, implement an online platform, and explore appropriate alliances.

Board & management

There has been significant change on the board with Bruce Baird, James Hyndes, Benjamin Lunn, Edward Keller and Andrew Leary all departing during FY12.

RDH’s board is chaired by corporate advisor Bill Beerworth, with Exto Partners director William Deane and former Maquarie Graduate School of Management lecturer Dr Christopher Clark joining him on the board, alongside CEO Glenn Elith, who was appointed in May 2012.

Mr Elith has been appointed as a numbers man—he was RDH’s CFO before taking the helm—rather than an education expert. He is a charted accountant experienced in business transformations and turnarounds, including stints with Lion Nathan and George Weston Foods. He was CFO at organic retailer Macro Wholefoods Markets, which was sold to Woolworths in 2009.

Financial performance

Its revenue line has been stable, generating $14.5m in FY12 and $14m in FY11—but its bottom line has been in the red for the past few years. After significant pain and restructuring, RDH has reported that it was EBITDA-positive in the September quarter of FY13. This translated into positive cash generation too.

In FY12 RDH had to book a $3m impairment charge for the Creative Design business unit and reverse a previously recognised $1.8m deferred tax asset. This was on top of negative EBITDA of -$1.4m, compared to -$1.1m in FY11. However, operating cash flow was positive, generating $0.4m in FY12 thanks to positive working capital movements. Below the EBITDA line, RDH’s earnings have been further hampered by the amortisation of capitalised Copyrights, which a $1.49m charge in FY12 and a $1.39m charge in FY11.

Reported book value at June 30 was $6.7m, including $7.9m in intangibles. Other key shareholders are Redhill Partners (5.1m shares), Regal Funds Management (3.1m shares) and Welas (1.5m shares).

What AKG could do with RDH

- We note that $2.2m of RDH’s cost structure relates to its property & occupancy costs. We’d expect AKG to act on site rationalisation, reducing that expense.

- RDH’s expense on staff was 57% of revenue in FY12 compared to AKG’s 21% (which is not directly comparable because of Fasteners) or NVT’s 35%. We’d expect AKG would be capable of driving savings.

RDH’s market cap is currently $3.8m so AKG could pay a significant premium and still pay a price as a multiple of revenue that is significantly lower than its own.

In fact, RDH’s net cash position at June 30, 2012, was $3.2m so after factoring in positive cash flow in the September quarter, the market cap is close to cash-backing (albeit with $4m of deferred income to be earned).
Target Markets & Industry Background

AKG is predominantly focused on international students (although its 51%-owned Benchmark subsidiary is domestically-oriented), offering bridging courses, undergraduate degrees, diplomas, vocational training and English language study.

Although under-represented in the listed market, education is one of Australia’s largest industries, ranking in the top 10 for “Gross Value Added” in the national accounts.

Education has been a key “export” industry, with the historical standards of Australian education and its vicinity to Asia making it a popular destination for international students. At the peak in 2009 there were just under 500,000 international students enrolled in courses in Australia.

However, enrolments began to decline post-2009 thanks to four key factors:

- negative international publicity regarding international student safety;
- changes to Australia’s migration policies (stronger integrity checks were introduced, required available funds for living costs rose 50% to $18k);
- the collapse of a number of education providers;
- and the rise of the Australian dollar made other English-speaking destinations (UK, Canada, NZ, US) more attractive (however we note later in this report how FX fluctuations between the economies from which international students are drawn have not been as dramatic as AUD/USD).

AKG faces a highly fragmented market

While universities dominate the Higher Education category (and even then there are 135 businesses competing in this category), the key educational segments in which AKG competes are highly fragmented.

There are currently 4,910 Registered Training Organisations (RTOs), according to the Australian Government’s training.gov.au, with another 118 suspended

Figure 5: Australia’s top industries by Gross Value Added (FY12)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Financial and insurance services</td>
</tr>
<tr>
<td>2</td>
<td>Construction</td>
</tr>
<tr>
<td>3</td>
<td>Manufacturing</td>
</tr>
<tr>
<td>4</td>
<td>Mining</td>
</tr>
<tr>
<td>5</td>
<td>Professional, scientific and technical services</td>
</tr>
<tr>
<td>6</td>
<td>Health care and social assistance</td>
</tr>
<tr>
<td>7</td>
<td>Transport, postal and warehousing</td>
</tr>
<tr>
<td>8</td>
<td>Public administration and safety</td>
</tr>
<tr>
<td>9</td>
<td>Education and training</td>
</tr>
<tr>
<td>10</td>
<td>Retail trade</td>
</tr>
</tbody>
</table>

Source: ABS, Investorfirst

VET: Vocational Education & Training

Vocational institutions include skill-based courses which are closely linked to selected industries and give students practical skills and industry experience. Courses are provided at both government-funded Technical and Further Education (TAFE) institutes and private institutions. Many vocational institutes have links and agreements with universities. Through these links, universities may offer up to one year of advanced standing into a Bachelor degree as well as guaranteed entry into your course when you achieve the required grades at your vocational institution. Many of the courses provide advanced standing into university degrees.

Source: IDP
Target Markets (cont.)

or awaiting re-registration. RTOs are vocational education organisations that meet the requirements of the Australian Quality Training Framework. The focus of RTOs is on qualifications from Level 1 to Level 4 (these are Certificates, while a diploma is level 5 and a bachelor degree or graduate diploma is Level 8 under the Australian Qualifications Framework).

In addition, IBIS World estimates that there are over 11,600 businesses offering Language and other educational services (ranging from business colleges to driving schools).

At the time of its IPO in December 2004, Navitas (ASX code: NVT) was the leading aggregator of private education institutions in Australia. But now NVT has a $1.5 billion market capitalisation and a global footprint, consolidation of small colleges is unlikely to be its priority (the last small deal it did was the $3.1m purchase of Health Skills Australia in July 2010).

We currently consider AKG to be a lead aggregator. We also note offshore interest, particularly with US-based and private equity-backed international group Laureate Education paying $15.5m for a 20% stake in Think: Education Group sold by Seek (ASX code: SEK) in August 2012. Laureate was also reported as the under-bidder in the 2011 sale of Carrick Institute of Education, which turns over ~$60m a year and was bought by US-based Kaplan.

Australian industry in stabilisation mode

We understand the International Education Association of Australia is forecasting a decline in international student numbers to 485,000 in 2013 from 499,302 in 2011, with the peak not to be recovered until 2020. Similarly, industry researcher IBISWorld’s projection for the overall Higher Education sector is that revenue will decline in FY13 (from total revenue of $26 billion including a $4.1 billion contribution from international students).

NVT described FY12 as the “toughest year” in its history. But it reported that enrolments for Semester 2 of CY2012 (the mid-year semester) had shown stabilisation, with a 2% increase on the previous year. It was optimistic on the outlook for FY13, indicating new enrolments of international students to its Australian colleges were “showing good growth for the upcoming 201203 and 201301 semesters… there are emerging trends of improving demand which should reflect positively in FY13 and beyond”.

Knight Review

Michael Knight was commissioned to review the student visa program in 2010 and delivered a report in March 2011. We see the proposed reforms as the initiation of a “shake-out” in the sector that will advantage credible players, particularly the universities and professional groups like AKG.

Knight recommended streamlined processing arrangements for higher education, vocational education & training (VET) and, where packaged with a university course, English language training (ELICOS). The report also recommended graduates be entitled to work in Australia for two years, gaining practical experience; and that the ability to speak English cease to be a pre-requisite for those seeking to learn English. Most of these recommendations were accepted by the government, with implementation occurring in two stages (November 2011 and March 2012).

A high level of fragmentation: 135 higher education providers, 4,910 RTOs & 11,600 providers of other education & training

A healthy level of offshore M&A interest

Signs of industry stabilisation in CY2012

We view Knight reforms a “shake out” advantaging credible players like AKG
Target Markets (cont.)

Currency issue overplayed
We don’t believe currency fluctuations are a major factor in demand for Australian education. Figure 7 (below) shows that currency baskets weighted by origin of international students have not had the same shift as the AUD/USD. The currencies of the nations where international students are coming from are quite often more correlated with our the AUD than the USD.

For Figure 7, we have detailed industry-wide data and separately we have estimated AKG’s weightings based on our knowledge that it has a lesser weighting to China and a greater weighting to Indonesia and Brazil than the overall industry. Overall these estimates equate to a ~2% change for AKG’s weighting and a -4.5% change for the industry since October 2007.

Figure 7: Student origin-weighted index for changes in AUD with Oct 2007 base

International students are generally not swapping from currencies tied to the US dollar

Education tied to aspiration
We believe demand for education is relatively price “inelastic”. The middle-class and upper middle-class families in Asia and other developing regions want a high quality education and employment opportunities for their children. A course fee increase in local currency is not the overwhelming determining factor. Australia continues to attract international students because it has a reputation for a high standard of education, a favourable climate and a Western, English-speaking society.

A recent survey by leading education agent IDP Education concluded that the primary drivers for students in choosing their destination country are quality of education and international recognition of qualifications. It reported that Australia “leads on graduate employment opportunities and is also perceived as safe”, while the USA and UK are perceived to have the highest quality of education and Canada the most affordable (and most favourable in terms of visa policies).
Target Markets (cont.)

Furthermore, an annual study by ICEF Monitor of international education agents continues to find that Australia is considered: (a) one of the five most attractive study destinations; and (b) the study destination with the equal lowest portion of agents considering it unattractive (3%). This survey of 1,023 agents from 107 nationalities is set out below.

We note that the percentage of agents ranking Australia as “Very attractive” has recovered almost all the ground lost in 2009 and 2010. Importantly for the likes of AKG, Australia is perceived to be the best in terms of vocational education.

Figure 8: Agents’ view of most attractive countries for study abroad

Australia is one of the most attractive study destinations from the agents’ point of view

More broadly, 80% of agents expect the undergraduate and graduate markets to grow further in 2013.

Opportunities to increase domestic student business

AKG’s primary exposure to domestic students is through its Benchmark subsidiary. There is an emerging opportunity for educators like AKG to play in the domestic student market thanks to a move to contestability for vocational training. New South Wales has recently announced that from 2014 students will be able to choose government-subsidised courses through either the government-managed TAFE system or from private operators, ending a TAFE strangle-hold. Victoria moved in this direction in 2009, resulting in TAFE’s share of publicly-funded students reportedly falling to 45% from 66%.

Government-subsidised vocational market to open up in NSW to private educators from 2014, following Victorian lead
Target Markets (cont.)

Tertiary student volumes to scale up globally
On current trends, the world is looking at a shortfall of 38m to 40m tertiary-educated workers by 2020, according to a McKinsey Global Institute study, equating to 13% of the demand for such workers. It projects a 31% rise in workers with tertiary education by 2030 in advanced economies, while in China it sees the number multiplying 2.5 times.

This means that in addition to the usual incentive for those in the middle-and-upper classes of developing regions to seek further education, corporate and government programs will likely encourage broader demographics.

While in aggregate this should mean greater global demand for tertiary education, it does not mean that the current industry structure will remain in place. Asia, for example, is likely to bolster domestic educational capacity, while online communication will widen the options available to students.

McKinsey cites the case of Germany, where vocational training is conducted jointly by vocational schools and educational institutions, with students splitting their time between the two.

Figure 9: Projected shift in number of workers with tertiary education

![Diagram showing projected shift in number of workers with tertiary education](Source: McKinsey Global Institute)

Fasteners
Premier Fasteners is a small player in a fragmented industry. The “Nut, Bolt, Screw and Rivet Manufacturing” industry has annual revenue of $535m a year, according to IBIS World, and has shrunk at an annual rate of -3.8% over the past five years. The largest players are Ajax Engineered Fasteners (formerly part of Austrim Nylex), Bremick (~$491m total revenue according to Capital IQ) and Australian subsidiaries of Illinois Tool Works (eg Ramset).

It is an industry facing pressure from large-scale, low-cost offshore manufacturers. As such, Premier has been positioned as a niche maker of specialised fasteners or fasteners that are needed quickly.

Similarly, the end-customers have tended to be manufacturing industries that have been struggling to compete with imports: automotive, industrial machinery, furniture and construction.
Historical Financials

Annual revenue has grown at a compound rate of 22% a year between FY05 and FY12 to $33.9m. Net profit has grown to $2.5m in FY12 from a $2m loss in FY05. EPS has grown to $0.05 in FY12, with dilution due to scrip-payments for acquisitions causing a decline from the peak of $0.06 in FY11.

Growth has occurred progressively, although FY08 reported earnings distort the trend shown in Figure 10 (below), as they included $3.6m in one-off gains.

Back in 2005 the Education segment represented just 26% of revenue and contributed a loss to the group. The following year it broke even. Since then its contribution to revenue has advanced progressively to 77% in FY12 while its contribution to pre-tax earnings rose to 89%.

Fasteners has been slow-but-steady at the top-line. Annual revenue for this segment has grown 22% over the full five years to $7.7m from $6.3m in FY05. But pre-tax profitability has been more volatile, contributing $0.6m to FY12, after peaking at $1.2m in FY10, compared to $0.15m in FY05.

Education became a larger pre-tax profit contributor than Fasteners in FY07 and a larger revenue contributor in FY08.

Cashflow & working capital

Operating cash flow has exceeded net profit in five of the past eight half-years, including four of the past five. In general, as long as student numbers are improving, AKG should be able to report strong cash flow as it receives payments in advance for courses—at June 30, 2012 it held $1.5m in advance payments. However, in 2H12 operating cash flow equated to only 56% of earnings as tax liabilities were paid down.

Our main area of focus in terms of working capital is inventory—which is tied to the Fasteners segment. Days inventory has risen to ~345 days in 2H12 from 261 days in 1H11. Inventory carried on the balance sheet has risen to $3.65m from $3.04m over that period. Other than the risk of aged inventory, AKG’s balance sheet appears strong with net debt of just $0.3m at June 30, 2012.

Figure 10: AKG’s historical revenue and earnings

Source: Capital IQ

Annual revenue has grown 22% a year since FY05 while EPS has emerged from losses pre-FY07 to $0.05 in FY12

Student prepayments bolster cashflow while there may be room to improve Fasteners’ inventory

 FY08 earnings were boosted by a change in accounting ($2.47m) & the write back of future income tax benefits ($1.17m)
EBITDA margins & consolidation

Segment data indicates that AKG has run an efficient Education business. Its EBITDA margins are in-line with those of considerably larger regional peers—around the 20% mark in FY12.

In fact, AKG achieved a margin just below 25% for this segment in FY11.

The healthy margins achieved give us confidence in the company’s ability to generate value through consolidation, where we expect the smaller businesses it acquires will not be as efficient in their processes and structure (and of course will benefit from scale).

Earnings Forecasts

We expect AKG to continue to grow the top-line at double-digit rates in FY13 and FY14, flowing through to EPS.

Key drivers of this growth are:

- A stronger contribution from 51%-owned Benchmark College in the latter half of FY13 on the basis that government spending on training should trend upwards leading into an election year after a pull-back in FY12.
- A boost from the acquisitions of a stake in Capoeira and the purchase of Discover English.
- The expectation that, in general, the international student market is stabilising and will accommodate mid-single-digit growth in student numbers.
- Ongoing inflation-type growth in tuition fees.
- Margin expansion in the Education segment

We assume the Fasteners segment does not expand its earnings, continuing to contribute <$1m to EBIT.

Summing it up

Our FY13 forecast is that AKG will generate $38m revenue (up 14%) for $5.8m EBITDA and a net profit of $3.1m. That translates to EPS of $0.065, compared to $0.053 in FY11 (up 22.9%).

In the following year we’re projecting another 12% top-line growth with some margin expansion for EPS of $0.08 (up 22.5%).

Note that net profit and EPS is affected by minority interests and equity-accounted profits. Furthermore, we have not factored in any acquisitive growth.
Valuation

We value AKG at $0.88 a share, the mid-point between our DCF and sum-of-the-parts valuation estimates. This implies a P/E of 13x, based on our FY13f EPS, which is lower than the average and median of its peers (see Figure 12 below).

AKG has historically traded at around 9x to 10x trailing earnings, reflecting its illiquidity and, in our opinion, the lower capitalisation the market would apply to its Fasteners segment, relative to the Education segment.

On the basis of our FY13 forecasts, AKG is currently priced on 13x expected EPS of $0.065.

On one hand, that means AKG is priced in-line with the 13x multiple of the S&P/ASX Small Industrials and below the average of 18x that its peer group trades on.

But on the other hand, AKG is a highly illiquid and tightly-held stock that has not traded at all in the past month.

Thus we classify AKG essentially as a “private company in a public market”. Our assessment of value, therefore, takes into account a discount for liquidity.

Sum of the parts

Given AKG’s earnings are sourced from two very different businesses, we think it is important to assess each on its own merits. As discussed earlier, ideally we would like to see AKG divest its Fasteners business and reinvest the proceeds in further expanding its Education operations. Our sum-of-the-parts valuation estimate is $0.86—as detailed on the following page.

Education

AKG’s most relevant education peers are trading on a median of 17x FY13f consensus EPS—or 11-13x EV/EBITDA. The smallest and least liquid of its peers, G8 Education (an ASX-listed childcare business that faces considerably different market opportunities to further education businesses), trades at the lowest end of that range, being 11x.

<table>
<thead>
<tr>
<th>EV/EBITDA</th>
<th>P/E</th>
</tr>
</thead>
<tbody>
<tr>
<td>NVT</td>
<td>11.5x</td>
</tr>
<tr>
<td>GEM</td>
<td>6.1x</td>
</tr>
<tr>
<td>SEK</td>
<td>10.3x</td>
</tr>
<tr>
<td>SGX:NR7</td>
<td>9.8x</td>
</tr>
<tr>
<td>NYSE:EDU</td>
<td>10.6x</td>
</tr>
<tr>
<td>AKG (Investorfirst)</td>
<td>6.6x</td>
</tr>
<tr>
<td>Median</td>
<td>10.0x</td>
</tr>
<tr>
<td>Average</td>
<td>9.2x</td>
</tr>
</tbody>
</table>

Source: Capital IQ

Figure 12: Education peers’ forward multiples (based on consensus)
Valuation (cont.)

- **Fasteners**
  Identifying peers for the Fasteners business is not straightforward. There is no ASX-listed peer. In the Building Products segment, GWA Group is priced on a forward PE of 14.5x (in-line with Small Industrials) and an EV/EBITDA of 8.4x.

  There are some small fasteners businesses listed in Osaka (Japan) but we don’t believe their multiples are applicable.

  There has been some M&A in the sector, although mostly in private markets with limited disclosure around price and earnings. We do know that Stanley Black & Decker has been paying 1.6-1.7x revenue for significantly larger and sophisticated fasteners businesses (and in the case of Singapore-based Infastech it paid 9.1x EBITDA).

  Looking more broadly at ASX-listed industrial & consumer stocks with market capitalisations between $20m and $60m, the average trailing EV/EBITDA is 7.3x (or 6.6x weighted by market cap).

- **Summing it up**
  We have used a 6x EV/EBITDA multiple in assessing the value of Fasteners. For Education we use 8.7x, reflecting the average of peers less a 10% discount for liquidity. Corporate overheads are calculated on Education’s multiple.

Figure 13: Peers’ forward multiples (based on consensus)

<table>
<thead>
<tr>
<th>Segment</th>
<th>EBITDA</th>
<th>Multiple</th>
<th>Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>5.8</td>
<td>8.7x</td>
<td>50.9</td>
</tr>
<tr>
<td>Fasteners</td>
<td>0.9</td>
<td>6.0x</td>
<td>5.4</td>
</tr>
<tr>
<td>Overheads</td>
<td>-2.0</td>
<td>7.0x</td>
<td>-14.0</td>
</tr>
<tr>
<td>Minorities etc.</td>
<td>-0.1</td>
<td>8.7x</td>
<td>-1.0</td>
</tr>
</tbody>
</table>

EV attributable to AKG: 4.6, 8.9x, 41.2
Net debt: -0.28
Equity attributable to AKG: 40.9
Valuation per share: 50.86

Source: Capital IQ

Higher valuation from discounted cash flow

Our DCF valuation estimate, using a three-stage model, is higher at $0.90.

It assumes:
- Base cost of equity of 11.8%
- An additional discount to the valuation of 10% for illiquidity
- Explicit cash flow forecasts through to FY17, followed by a five-year ramp down to an inflation-type terminal growth rate of 2.5%
- A peak in EBIT margins in FY15 at 16.7%, followed by a gradual decline to 13.6% at the terminal year of FY22

Note that under this method cash flows from both segments have been discounted at the same rate.

We expect Fasteners would attract lower earnings multiples than Education should the businesses be split
Key Risks

Reputation & regulation
Students are typically expected to seek out the education provider with the highest reputation. Indeed, a study by Prospect Research and Marketing suggested 70% of students were influenced by league tables. Any damage done to the reputation of a college will, therefore, have an impact on enrolment demand. Adverse publicity surrounding the educational standards of second-tier tertiary education in Australia, particularly in relation to international students, may also become a reputational issue.

Government enforcement of education standards also poses a risk to any educator that slips in its standards. In October headlines were made in India when three vocational training colleges were closed for non-compliance with standards. Colleges that continue to meet the standards must work to ensure such news does not tarnish the reputation of the broader industry.

Government policy
Education is a highly regulated sector in which government-funding is essential (for domestic students). Educating international students has the added policy overlay of immigration, making this sector one highly reliant on government. However, AKG has partially countered this risk through its expansion into Singapore.

Offshore & domestic competition
Factors that can impact upon demand from international students for Australian education include competition from other leading providers of education to international students (e.g. US, Canada and UK); foreign currency fluctuations and popular trends (i.e. being the “in” country to visit). Online courses from the likes of the University of Phoenix (US) are also

Online competition
“Massive Open Online Courses” (MOOCs) are offerings of expert tuition online. Free MOOCs have been conducted by prestigious universities like Stanford, Harvard and Columbia, not to mention Melbourne. It is feasible that at some point in the future wealthy students in developing countries will be able to enrol at such prestigious universities and study from their lounge rooms. A risk to educators of lower ranking is that an online degree or diploma from a prestigious university could be perceived as being better than a real degree from a 2nd or 3rd-tier educator.

Litigation
International students are reportedly beginning to turn to lawyers when they fail to get the results they require.

Industry change
There is an argument that the current university model in Australia—an oligopoly of large teaching and research institutions with significant assets—will become unviable in the next 20 years. Ernst & Young has speculated in a recent “University of the future” report that private universities—and possibly public universities—will create new products and markets, merging different parts of the education sector. This could potentially lead to better-resourced institutions competing in the vocational education sector in pursuit of revenue from international students.
## Academies Australasia Group

**ASX code**: AKG  
**Bloomberg**: AKG AU  
**Reuters**: AKG.AX

---

### Financial Year End: June 30

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>FY11a</th>
<th>FY12a</th>
<th>FY13f</th>
<th>FY14f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenue</td>
<td>25</td>
<td>34</td>
<td>38</td>
<td>43</td>
</tr>
<tr>
<td>EBITDA</td>
<td>3.8</td>
<td>4.9</td>
<td>5.8</td>
<td>6.8</td>
</tr>
<tr>
<td>Deprec &amp; Amort</td>
<td>-0.5</td>
<td>-0.7</td>
<td>-0.8</td>
<td>-0.9</td>
</tr>
<tr>
<td>EBIT</td>
<td>3.3</td>
<td>4.2</td>
<td>5.0</td>
<td>5.9</td>
</tr>
<tr>
<td>Net interest expense</td>
<td>0.0</td>
<td>-0.2</td>
<td>-0.2</td>
<td>-0.2</td>
</tr>
<tr>
<td>PBT</td>
<td>3.3</td>
<td>4.0</td>
<td>4.8</td>
<td>5.7</td>
</tr>
<tr>
<td>Abnormal</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Equity-accounted &amp; minorities</td>
<td>0.1</td>
<td>-0.5</td>
<td>-0.3</td>
<td>-0.2</td>
</tr>
<tr>
<td><strong>Reported net profit</strong></td>
<td>2.3</td>
<td>2.5</td>
<td>3.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Adjusted net profit</td>
<td>2.4</td>
<td>2.4</td>
<td>3.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Reported EPS</td>
<td>$0.055</td>
<td>$0.053</td>
<td>$0.085</td>
<td>$0.080</td>
</tr>
<tr>
<td>Adjusted EPS</td>
<td>$0.055</td>
<td>$0.053</td>
<td>$0.085</td>
<td>$0.080</td>
</tr>
<tr>
<td>Dividends per share</td>
<td>$0.040</td>
<td>$0.045</td>
<td>$0.052</td>
<td>$0.064</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash Flow</th>
<th>FY11a</th>
<th>FY12a</th>
<th>FY13f</th>
<th>FY14f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported net profit</td>
<td>2.3</td>
<td>2.5</td>
<td>3.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Deprec &amp; Amort</td>
<td>0.5</td>
<td>0.7</td>
<td>0.9</td>
<td>0.9</td>
</tr>
<tr>
<td>Working capital</td>
<td>-0.2</td>
<td>1.1</td>
<td>-0.3</td>
<td>-0.5</td>
</tr>
<tr>
<td>Net operating cash flow</td>
<td>3.2</td>
<td>3.3</td>
<td>2.9</td>
<td>4.2</td>
</tr>
<tr>
<td>Capex</td>
<td>-0.3</td>
<td>-0.6</td>
<td>-0.8</td>
<td>-0.9</td>
</tr>
<tr>
<td>Acquisitions</td>
<td>-2.7</td>
<td>0.0</td>
<td>-0.3</td>
<td>0.0</td>
</tr>
<tr>
<td>Others</td>
<td>-0.2</td>
<td>-0.1</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Net investing cash flow</strong></td>
<td>-3.2</td>
<td>-0.7</td>
<td>-1.1</td>
<td>-0.9</td>
</tr>
<tr>
<td>Change in debt</td>
<td>2.8</td>
<td>-0.4</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Equity issuance</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Dividends</td>
<td>-1.7</td>
<td>-1.9</td>
<td>-2.5</td>
<td>-2.8</td>
</tr>
<tr>
<td>Other</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Net financing cash flow</strong></td>
<td>1.1</td>
<td>-2.3</td>
<td>-2.5</td>
<td>-2.8</td>
</tr>
<tr>
<td><strong>Net cash flow</strong></td>
<td>1.2</td>
<td>0.4</td>
<td>-0.6</td>
<td>0.6</td>
</tr>
</tbody>
</table>

### Balance Sheet

<table>
<thead>
<tr>
<th>FY11a</th>
<th>FY12a</th>
<th>FY13f</th>
<th>FY14f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>3.6</td>
<td>2.6</td>
<td>2.0</td>
</tr>
<tr>
<td>Receivables</td>
<td>2.2</td>
<td>2.4</td>
<td>2.9</td>
</tr>
<tr>
<td>Inventory</td>
<td>3.1</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>Other</td>
<td>0.8</td>
<td>0.8</td>
<td>0.9</td>
</tr>
<tr>
<td>Total current assets</td>
<td>9.7</td>
<td>9.5</td>
<td>9.4</td>
</tr>
<tr>
<td>PP&amp;E</td>
<td>3.5</td>
<td>3.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Intangibles</td>
<td>9.4</td>
<td>10.0</td>
<td>10.3</td>
</tr>
<tr>
<td>Other non-current</td>
<td>0.7</td>
<td>0.9</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total non-current assets</strong></td>
<td>13.6</td>
<td>14.1</td>
<td>14.4</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>23.3</td>
<td>23.0</td>
<td>23.8</td>
</tr>
<tr>
<td>Current debt</td>
<td>0.7</td>
<td>1.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Payables</td>
<td>1.0</td>
<td>2.6</td>
<td>3.3</td>
</tr>
<tr>
<td>Provisions</td>
<td>1.4</td>
<td>1.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Other</td>
<td>2.9</td>
<td>1.5</td>
<td>1.7</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td>6.8</td>
<td>6.6</td>
<td>6.5</td>
</tr>
<tr>
<td>Non-current debt</td>
<td>2.7</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Other</td>
<td>0.3</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Total non-current liabilities</strong></td>
<td>3.0</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>9.0</td>
<td>9.0</td>
<td>9.0</td>
</tr>
<tr>
<td><strong>Net assets</strong></td>
<td>13.4</td>
<td>14.5</td>
<td>14.8</td>
</tr>
<tr>
<td><strong>Net assets</strong></td>
<td>4.0</td>
<td>4.6</td>
<td>4.6</td>
</tr>
<tr>
<td><strong>Net debt</strong></td>
<td>-0.1</td>
<td>0.3</td>
<td>0.9</td>
</tr>
</tbody>
</table>

---

### Valuation Metrics

<table>
<thead>
<tr>
<th>FY11a</th>
<th>FY12a</th>
<th>FY13f</th>
<th>FY14f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price / earnings (rep)</td>
<td>14.5x</td>
<td>15.1x</td>
<td>12.8x</td>
</tr>
<tr>
<td>Price / earnings (adj)</td>
<td>14.5x</td>
<td>15.1x</td>
<td>12.8x</td>
</tr>
<tr>
<td>E/V/EBITDA</td>
<td>9.5x</td>
<td>7.5x</td>
<td>6.6x</td>
</tr>
<tr>
<td>E/V/EBIT</td>
<td>11.4x</td>
<td>9.1x</td>
<td>7.6x</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>5.0%</td>
<td>5.6%</td>
<td>6.5%</td>
</tr>
<tr>
<td><strong>Current price / book</strong></td>
<td>2.6x</td>
<td>3.0x</td>
<td>5.5x</td>
</tr>
</tbody>
</table>

### Margins & Growth

<table>
<thead>
<tr>
<th>FY11a</th>
<th>FY12a</th>
<th>FY13f</th>
<th>FY14f</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA margin</td>
<td>15.3%</td>
<td>18.4%</td>
<td>15.0%</td>
</tr>
<tr>
<td>EBIT margin</td>
<td>15.3%</td>
<td>12.4%</td>
<td>13.0%</td>
</tr>
<tr>
<td>PBT margin</td>
<td>13.3%</td>
<td>12.0%</td>
<td>12.5%</td>
</tr>
<tr>
<td>Adj. net profit margin</td>
<td>9.6%</td>
<td>7.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Revenue growth</td>
<td>46.9%</td>
<td>34.5%</td>
<td>13.8%</td>
</tr>
<tr>
<td>EBITDA growth</td>
<td>36.4%</td>
<td>28.1%</td>
<td>17.3%</td>
</tr>
<tr>
<td>Adj. EPS growth</td>
<td>47.4%</td>
<td>4.1%</td>
<td>22.9%</td>
</tr>
</tbody>
</table>

### Segment Sales

<table>
<thead>
<tr>
<th>Investorfirst v consensus</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPS</td>
</tr>
<tr>
<td><strong>$8.00</strong></td>
</tr>
<tr>
<td><strong>$8.00</strong></td>
</tr>
<tr>
<td>EBITDA</td>
</tr>
<tr>
<td><strong>15.4x</strong></td>
</tr>
<tr>
<td><strong>15.4x</strong></td>
</tr>
</tbody>
</table>

### Capital Structure

<table>
<thead>
<tr>
<th>Investorfirst v consensus</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPS</td>
</tr>
<tr>
<td><strong>$8.00</strong></td>
</tr>
<tr>
<td><strong>$8.00</strong></td>
</tr>
<tr>
<td>EBITDA</td>
</tr>
<tr>
<td><strong>15.4x</strong></td>
</tr>
<tr>
<td><strong>15.4x</strong></td>
</tr>
</tbody>
</table>

---

**Recommendation**: Buy  
**Share price**: $0.800  
**Financial risk**: 3.2 (2Z Score) -2.7 (M Score)  
**Market risk**: 0.84 (inverted peers’ beta)  
**Options & other**: 0.0m  
**Market cap**: $37.9m

---

**Investorfirst Securities**  
**ACN 135 332 240**  
A Corporate Authorised Representative (no. 339 230) of HUB24 Custodial Services Ltd (ABN 94 073 633 664) (AFSL 239 122)

---

Please refer to the important disclosures at the end of this report.
Important Notices

This communication is distributed by Investorfirst Securities Ltd (ACN 135 332 240) (Investorfirst Securities), which is a corporate authorised representative (No. 339 230) of HUB24 Custodial Services Ltd (ABN 94 073 633 664) (AFSL 239 122). HUB24 Custodial Services Ltd is a participant of ASX Ltd.

Disclaimer

This communication is not intended to be a sufficient basis for an investment decision. Readers should consult detailed advice before making an investment decision. The information is general information only, it does not take into account your particular investment objectives, financial situation or needs. This communication is not an invitation or offer to buy or sell any securities. Prior to taking any action or making any investment decision, you should consult your professional advisors and consider whether the advice or proposed investment is appropriate in light of your particular investment needs, objectives and financial circumstances.

Investment involves risk. Past performance is no indication of future results.

Although we believe the information is accurate and reliable, Investorfirst Securities has not independently verified the information, which is provided from public sources, third parties and directors or management of issuers. Investorfirst Securities does not represent that the information in this communication is complete, up to date or reliable. Any opinion or forecast or recommendations reflect the information, assumptions and judgment as at the time of writing and may later change without notice. Investorfirst Securities is not responsible for updating any information, advice or opinion in this communication or for correcting or supplementing any information, advice or opinion in this communication for any error, omission or misstatement which may become apparent after its release.

Investorfirst Securities, to the extent permitted by law, accepts no liability or responsibility for any direct or indirect loss or damage caused by any misstatement or error in or omission from this communication or for relying on this communication.

Any views expressed in this communication by Investorfirst Securities accurately reflect the personal views of the author about the subject securities or issuer and may not be the same as the views of Investorfirst Securities. No part of the compensation of the author was, is or will be directly or indirectly related to the inclusion of specific recommendations or views in this communication. The material in this communication has been prepared by individual people within Investorfirst Securities who may from time to time also provide advice to individual or corporate clients.

The author principally responsible for this communication receives compensation based in part on revenue of Investorfirst Securities and has taken reasonable care to achieve and maintain independence and objectivity in making any recommendations.

Disclosure

Investorfirst Securities, its related companies and directors and employees (other than the authors of this communication) might have a relevant interest in some securities mentioned but those holdings are not material unless disclosed in this communication. These holdings (or absence of holdings) may change at any time after publication of this communication, without notice.

Investorfirst Securities, its related companies and employees, directors, consultants of any of them may earn income, fees, brokerage or commissions or other benefits as a result of recommendations, dealing or transactions in the securities mentioned in this communication or it may earn referral fees in respect of investors who participate in capital raisings by the issuers mentioned in this communication. There are no such arrangements currently in place. These interests do not influence Investorfirst Securities in giving the advice contained in this communication. The directors, employees, consultants or of Investorfirst Securities or of its related companies may trade in these financial products in a manner that is contrary to the recommendations given in this communication or by Investorfirst Securities to clients.

Confidentiality

This information is private and intended only for the particular person to whom it is sent. It remains confidential however it is distributed and it and any part of its advice are not to be communicated or disclosed to any other person without the written consent of Investorfirst Securities.

© 2012 Investorfirst Securities Ltd
Research Ratings Methodology

**Sell:** Valuation < (Share Price X 0.9)

**Hold:** Valuation > (Share Price X 0.9) < Share Price

**Buy:** Valuation > Share Price

**Speculative** (in addition to Buy/Hold/Sell): no history of positive earnings or cash flow; or highly geared; or highly volatile & inherently uncertain

Financial Risk Metrics

**General Z-Score:** indicator of risk of bankruptcy
- <1.1: may be in financial distress
- 1.1 to 2.6: potential warning of financial distress
- >2.6: may be in good financial shape

**Beneish M-Score:** indicator of potential earnings manipulation. A result below –2.22 indicates no apparent manipulation of financial results