

INSIGHTS

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India Education Infrastructure Opportunity





Ritesh Vohra

Ritesh has been a financier, advisor and entrepreneur over the course of his real estate career, and has been associated with a number of property developments across India.

At Investcorp India, his primary focus is on building and managing the real estate asset class. He is also responsible for overseeing the investment, asset management and divestment processes for the portfolio.

Prior to Investcorp, Ritesh worked as a Partner with IDFC Alternatives, India.

Ritesh completed his undergraduate studies in hospitality management from the Institute of Hotel Management, New Delhi and his post graduate program in management from the Management Development Institute, Gurgaon.

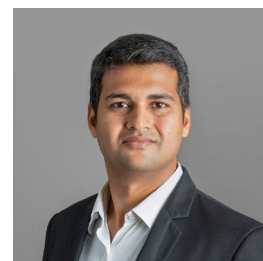
He has been a past member of the CII National Committee on Real Estate and Housing. He is also a member of the Royal Institution of Chartered Surveyors, United Kingdom (RICS).



Ajay Kumar

Ajay Kumar joined Investcorp in 2019. He is a real estate investment professional with over 15 years of diversified experience in financial services, of which over 10 years has been in the real estate space. His experience involved, successfully executing multiple investments in private equity and mezzanine funding covering the entire deal life cycle (origination, execution and asset management activities). Prior to Investcorp, Ajay worked with Indiabulls AMC and managing a USD 150 million domestic real estate office fund. Preceding that, he worked with IDFC Alternatives as well as Pramerica BHI and ICICI Bank.

Ajay completed his engineering from the IP University, New Delhi and MBA from the IIM Kolkata in 2005.



Kunal Patwa

Kunal Patwa is a real estate investment professional with close to 12 years of real estate investment experience. Prior to joining Investcorp in February 2019, he worked with IDFC Alternatives Ltd. as part of the real estate investment team. His earlier stints include working as part of the investment teams of Xander Finance Pvt. Ltd. and Yes Bank Ltd. He has experience of working across residential, commercial, hospitality and student housing asset classes within the real estate sector.

Kunal holds a Masters degree in Business Administration Studies from Jamnalal Bajaj Institute of Management Studies and a Bachelors degree in Information Technology from University of Mumbai.

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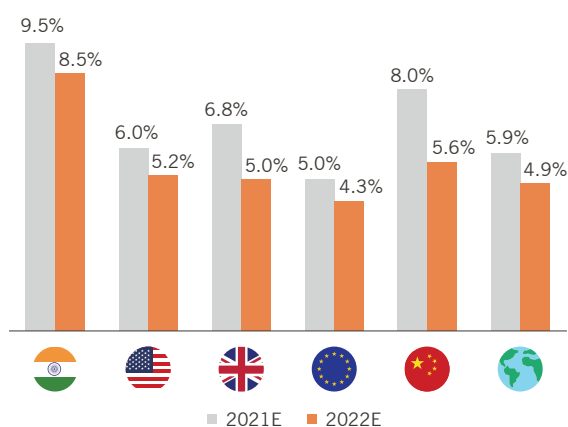
Indian Economy: Making rapid strides

India's structural economic reforms which began in 1991 brought about transformative changes making its economy market-oriented, expanding the role of private enterprise, and opening it up for foreign investment. Since then, economic liberalization process has steadily progressed, and the result has been a 9x increase in GDP to almost USD 3 TN now.

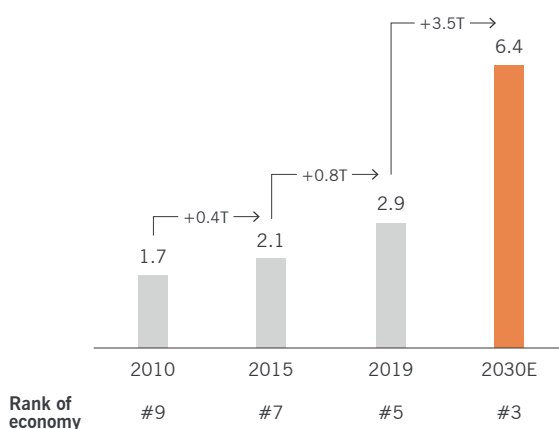
The Indian economy has been one of the fastest growing large economies in the world, second only to that of China. As per IMF estimates, India's GDP is expected to grow at a pace of 9% during FY23 and average growth rate of 8.3% per annum during 2021-2026, overtaking China to become the fastest growing large economy in the world. With a nominal GDP of \$2.9 trillion in 2019, India became the world's fifth-largest economy and third largest in the world by purchasing power, with the second-highest population of any country in the world.

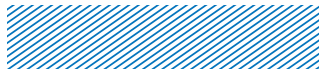
India expected to outgrow other major world economies

India expected to outgrow other major world economies



India projected to be a Top 3 economy by 2030





International investor interest towards India has grown manifold as evidenced by cumulative FDI inflows of USD 440 billion during the last seven years



India's strong fundamentals and long-term structural growth drivers like a young working population, increased urbanization, rapidly growing middle class and rising disposable incomes make it an attractive investment destination for long term investors. International investor interest towards India has also grown manifold as evidenced by cumulative FDI inflows of USD 440 billion during the last seven years, highlighting the accelerating trend of the rapidly growing global interest in India.¹

The Indian economy has been witnessing cumulatively positive improvements including macro-economic stability, favorable demographics, pro-reform governments, policy continuity, commitment to fiscal management, reduced interest rates, low inflation & stable currency.

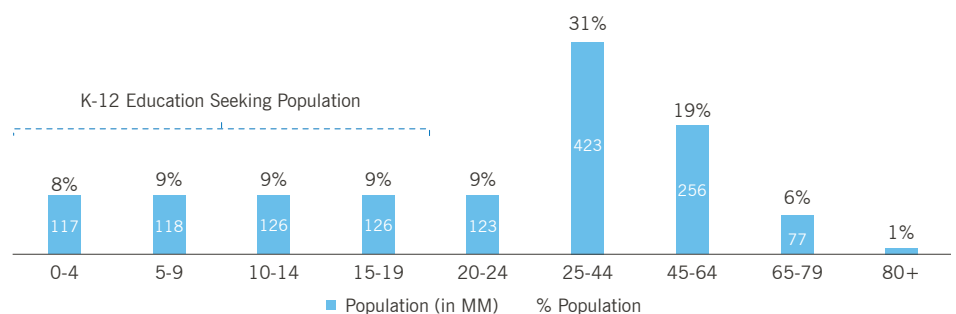
As a demonstration of its resilience, the economy has rebounded decisively after the multiple Covid waves and is expected to continue its long-term growth trajectory.

India's Education Sector

Given the large population base and young demographics, it is no surprise that India has amongst the largest number of education seekers anywhere in the world. With a diversified mix of public and private ownership, there are numerous institutions across the country – from the pre-primary level all the way to the university level – to cater to the needs of hundreds of millions of students that constitute over one-third of the country's population.



Population break-up by Age, 2020

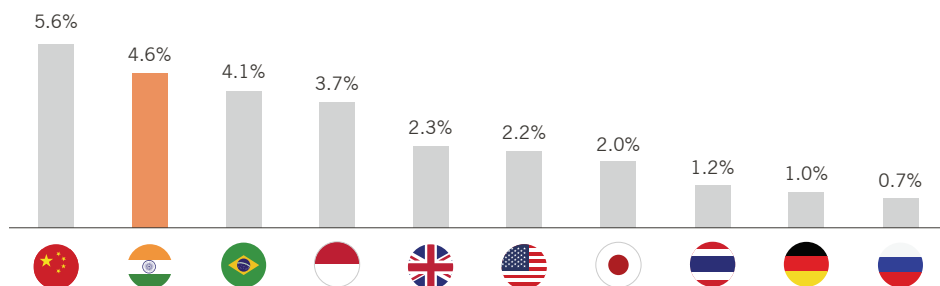


Source: World Bank

¹ <https://www.ndtv.com/business/fdi-inflow-data-india-registered-its-highest-ever-fdi-inflow-of-81-97-billion-in-fiscal-2020-21-government-2655686>

Further, in a developing country like India, quality education for children is seen by parents as the key enabler for upward mobility. Hence, the expenditure on education is typically non-discretionary in nature and not cut-back on even during economic downturns. In India, the spend on education as a percentage of the overall consumption expenditure is generally higher relative to more advanced economies and comparable emerging economies. This can be explained by the propensity of parents to spend on quality education at the cost of some discretionary expenses.

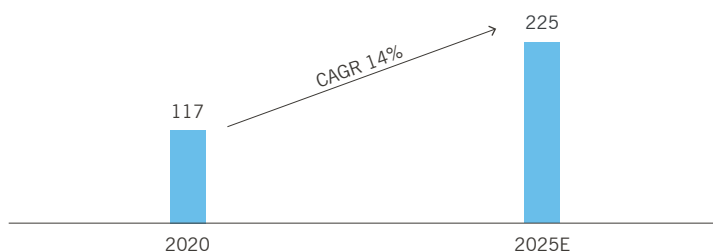
Education, % of consumption expenditure



Source: World Bank

Reflecting these underlying long term growth drivers, the education industry overall is expected to grow at a CAGR of 14% over the next few years to reach an overall size of USD 225 billion.

Education Industry Size, USD Billion



Source: IBEF Report, Mar '21

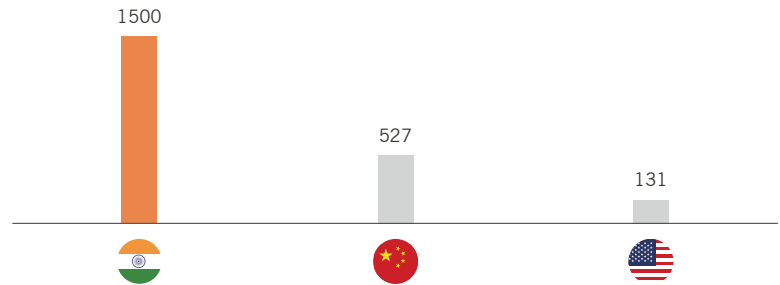
India's K-12 Landscape

Within the overall Education sector, the K-12 school system occupies the most significant sub-segment. Not only do the learners spend a very significant part of their student life here, but also these are the most critical formative years which have a lifelong impact on the learners' cognitive and problem-solving skills.

Private K-12 schools are more sought after by parents owing to the relatively better quality of education and superior infrastructure offered by them

India has the 2nd largest schooling system in the world with over 1.5 million schools and nearly 250 million enrollments. In fact, the K-12 sub-segment constitutes more than 50% of the overall size of the growing education industry in India.

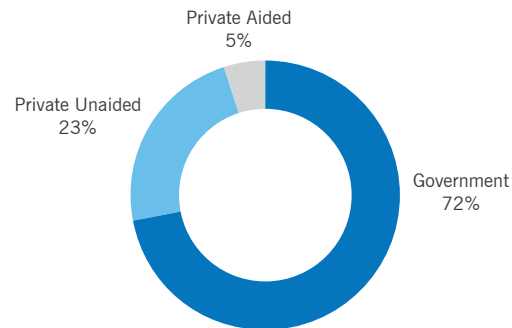
No. of Schools, in 000's



Source: Ministry of Human Resource Development

K-12 schools in India can be broadly classified as Government owned, Private Aided (privately owned and managed but receiving some form of government aid) and Private Unaided (financed entirely privately).

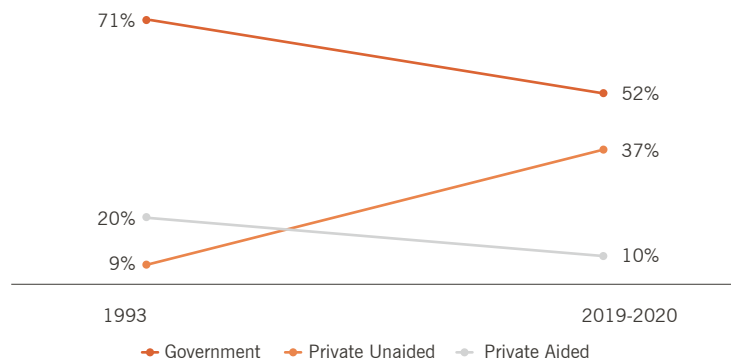
Break-up of Schools by Management



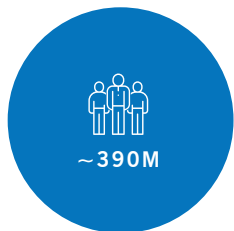
Source: State of Private Schools in India, Central Square Foundation

While the Government owned schools dominate in terms of sheer numbers, there has been a long-term trend of increasing share of private schools in total enrollments within the K-12 space in India, more specifically of the private unaided schools.

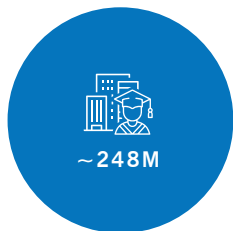
Private schools are perceived to provide better quality of education and superior physical & digital infrastructure compared to the government schools. There are several private school chain operators that have established their brands and replicated their models across various geographies in India.

% Enrollments

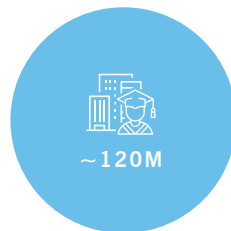
Source: Report – ‘State of Private Schools in India’, Central Square Foundation, Unified District Information System for Education Plus (UDISE+)

K-12 Segment Statistics

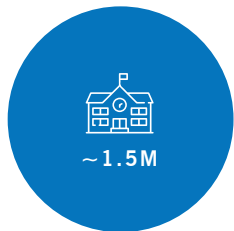
Population from 3 to 18 years



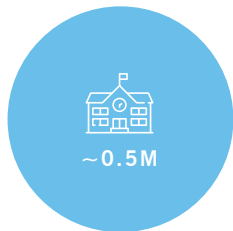
Enrolment in K-12 education



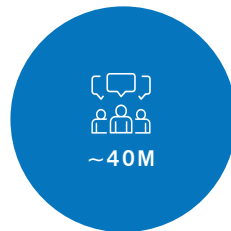
Enrolment in Private K-12 education



Number of K-12 schools



Number of Private K-12 schools

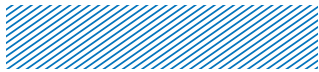


Number of English speaking students*

* Estimated using the proportion of English -speaking population to 3-18year old population
Source: Euromonitor, OECD; DISE 2018-19; MHRD (India); EY-Parthenon Research and Analysis

Impact of Covid-19

During the pandemic, unlike many other sectors, private K-12 schools swiftly transitioned to an online environment. Several K-12 operators have tied-up with education technology (“EdTech”) start-ups to provide a transformative experience through tools like smart classes and e-learning.



With growing institutionalization, there are now scores of chain operators in the mid & premium private K-12 space, each with a regional or national footprint

As the third Covid wave ebbed during February 2022, most K-12 schools across the country began the process of re-opening physical campuses and welcoming learners back for in person classes.

Going forward, in case of further disruptions from the pandemic, we expect most private K-12 schools to seamlessly transition between offline and online modes with minimal impact on their operations and revenues.

Private Investments into the K-12 Education Sector

From the above analysis, we can conclude that:

1. The Indian economy is growing and attracting increasing amounts of foreign investments
2. The Indian Education sector is a key beneficiary of long-term growth drivers like favorable demographics and recession-proof spending
3. The private K-12 school segment is growing rapidly to cater to the needs of the affluent and aspirational families

The high-quality private K-12 school operators in India are responding to this long-term growth opportunity by focusing on operations, quality and brand building; embracing technology; and becoming more capital efficient by going asset light.

Such operators recognize that there is limited value in owning the physical Education Infrastructure (land & buildings). On the contrary, to scale up rapidly, they need like-minded partners that invest in the infrastructure leaving the operators to focus on the core education business.

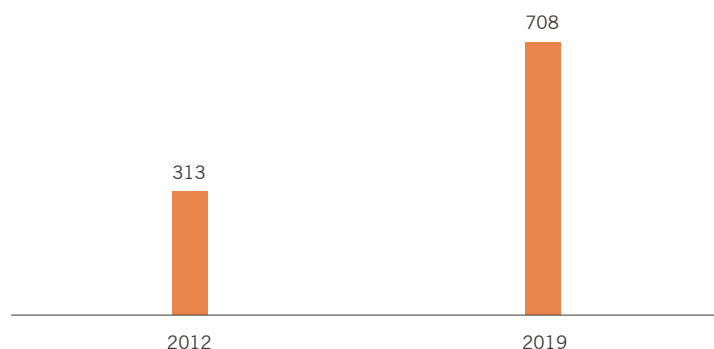
Some of the long-term trends supporting the thesis for institutional investments into the K-12 sector include:

Larger & Better Organized Operators: There are more than 20 chain operators in the mid & premium private K-12 space with between 30 to over 300 schools spread across the country. Many of these operators have professional management, focus on use of technology, minimum standards for the physical infrastructure across schools and standardization of various processes – all attributes that make them a preferred recipient of institutional capital.

Asset Light Models: K-12 schools require significant capital investment in land, building and other peripheral infrastructure. School operators, particularly chain operators, have typically preferred asset light growth models including leasing the infrastructure or creating partnerships, thereby increasing the need for third party investments.

Increasing Demand for International Schools: Changing parents' aspirations, increased acceptance by Indian universities and growth in the numbers of students going abroad for higher studies have all contributed to the rise of international schools that have seen an average annual growth rate of 8% between 2010 and 2019. With higher infrastructure specifications, such schools require relatively significant investments that an institutional investor is able to provide.

No. of International Curriculum Schools



Source: <https://timesofindia.indiatimes.com/india/intl-schools-double-india-at-second-spot/articleshow/72101112.cms>

K-12 Investment Landscape

Private K-12 education space has seen growing institutional investor interest in the last few years especially from foreign private equity investors and international school operators. As described above, this has largely been driven by the emergence of professional school chain operators, increasing penetration of technology within traditional pedagogy, demand for quality private education, need for growth capital and presence of acceptable legal structures.

This sector has seen transactions in excess of USD 700 million² since 2016 involving investments across operating businesses and/or physical infrastructure space. Some of the key investments include:

Sub-Sector	Investor	Investee / Seller	Location	Transaction Value (USD MM)
K-12	Sofina & Sequoia	K-12 Techno	Pan India	31
K-12	Foundation Holdings	Ryan International	Pan-India	100
K-12 + Preschool	KKR	EuroSchool	Pan India	209
K-12	Morgan Stanley & Banyan Tree	Narayana Group	South India	75

² Source: Investcorp Research

Education Infrastructure assets with underlying long term lease contracts can provide investors with stable yields generated from a fundamentally resilient Social Infrastructure sector

India has also emerged as one of the largest e-learning markets globally. Several K-12 operators have tied-up with education technology (“EdTech”) start-ups and the EdTech sector has seen USD 4.7 billion in India in year 2021³ alone. Prominent investors in the Indian EdTech space include General Atlantic, Tiger Global, Sequoia, Nexus Venture Partners, Sofina, Qatar Investment Authority, Michael & Susan Dell Foundation, CPP Investment Board, etc.

The Edu-Infra Investment Opportunity

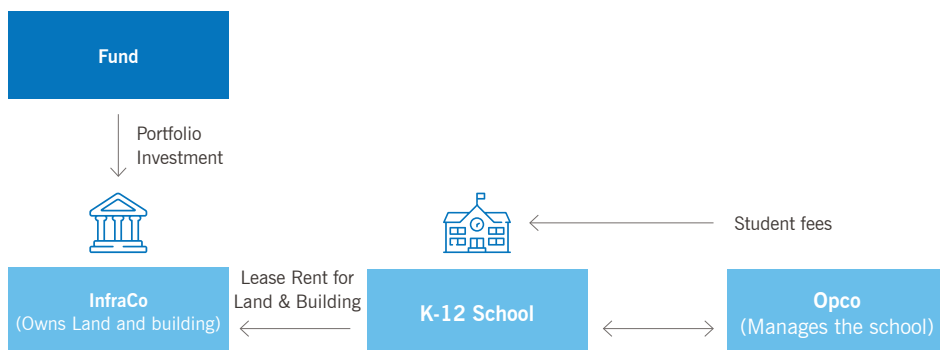
Given the rapid evolution of the private K-12 school operators and increasing focus on building this as an asset light scalable business, there exists an opportunity to create a diversified portfolio of school assets by acquisition of physical assets (land and building) of privately owned K-12 schools across key cities in India and lease the same to reputed well-established school operators on a long-term lease basis.

The asset class has features akin to Social Infrastructure with stable long-term yields and an attractive and resilient underlying sector.



The platform will provide school operators with the requisite capital for their business expansion while providing investors with a stable and regular yield over a period of 20-25 years. Further, attractive capital growth can be crystallized through the platform creation and subsequent potential listing of an Infrastructure REIT under Indian regulations that provide a favorable and efficient path to exit for investors.

³ <https://inc42.com/features/with-3-new-unicorns-indias-edtech-startups-raised-4-7-bn-in-2021/>



We believe the right segment to focus on here is the well-established schools in the larger cities, catering to the mid-income and upwards which are run by high quality institutional-minded operators. This creates a meaningful opportunity set with an attractive risk adjusted return profile.

Portfolio Construct

Having said the above, the key to risk mitigation here is ensuring the right portfolio construct using appropriate filtration criteria. Some of the key criteria are:

Operator: Partner with reputed chain operators with significant track record pan-India or at least in the target geography.

School Operations: Focus on established schools with 5+ years of track record and stabilized capacity utilization.

School Ownership: Focus on fully operator run schools rather than those operated under a franchise or management contract.

Curriculum: Focus only on national and international curriculum schools that are increasingly in demand as against state curriculum schools that typically have lower fee points and inferior infrastructure/ academic quality.

Fee Point: The offerings of the schools in terms of academic quality, infrastructure and student outcomes are correlated with the school's fee point. Focus on schools with fee point more than USD 1000 p.a.

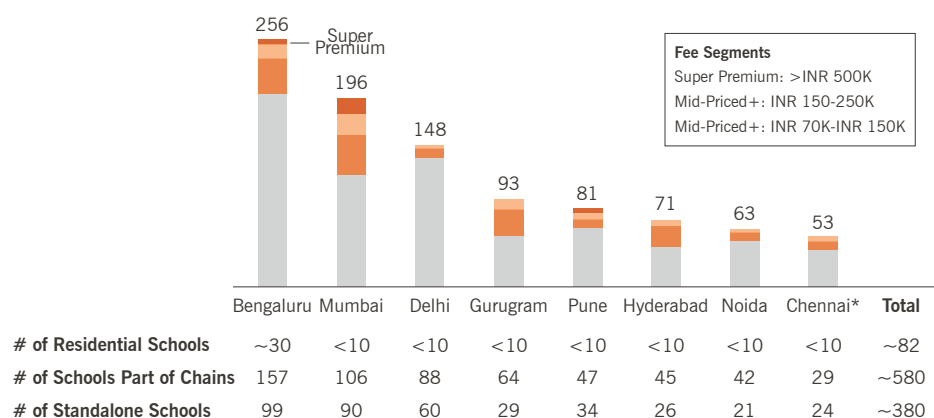
Geography: Top 8 cities offer higher affordability and demand for premium education. Schools in tier 2/tier 3 cities that are part of an operator chain also present attractive opportunities.

A portfolio of K-12 school assets meeting the above-mentioned criteria is likely to generate stable attractive yields in the long run and also provide attractive capital gains to the investors.

Appropriate risk mitigation can be achieved by focusing only on high quality schools & operators, and actively managing the portfolio with the help of an on-ground team

Overview of Target Schools Across Top 8 Cities

~1,000 K-12 Schools with an annual fee >INR 70K are located in the top 8 cities



Source: EY-Parthenon

Underlying Contract

The next key thing to focus on ensuring the underlying contracts with the school operator are watertight and comprehensive. Apart from the starting yield, the important clauses to focus on include the tenure, the break clause, rental escalations (contractual in India), rent escrow mechanisms, security deposits and information rights amongst others.

An appropriately structured contract with a high-quality operator for a well-established school asset can ensure the investment objectives are properly met.

Risks

Nonetheless, there are risks that need to be monitored and actively mitigated. Given the nature of the underlying operating business, the most critical amongst them is Operator Risk. Investors will need to ensure that the operator running the school is well-established, reputable and has a long-term mindset that makes signing 20-25 year leases credible.

The risk of rental default can be mitigated by only acquiring assets with stable school operations and of course, high quality operators.

Ensuring a profitable exit is another key risk. With increasing capital markets activity in this space, it is likely that a well-managed institutionally owned Edu-Infra portfolio will find many takers amongst the various investors active in the Indian real estate and social infrastructure sectors. This portfolio also has the potential to be listed as a REIT or Infrastructure Trust in due course.

Conclusion

Edu-Infra presents an interesting path to participate in the India growth story in a risk-mitigated manner. With attractive fundamentals and secular tailwinds, Edu-Infra



has the ability to generate steady yields over long periods of time. India being a growth market, there also exists the potential to generate sizeable capital gains.

Investors should approach this segment keeping key risks in mind, especially around the operator profile, maturity of school operations and the terms of the underlying contract. Further, the importance of having a local team on the ground to build and manage the portfolio can't be overstated. A careful consideration of these aspects while investing is a must for all investors.



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We invest a meaningful portion of our own capital in products we offer to our clients, ensuring that our interests are aligned with our stakeholders, including the communities that we operate within, towards driving sustainable value creation. We take pride in partnering with our clients to deliver tailored solutions for their needs, utilizing a disciplined investment process, employing world-class talent and combining the resources of a global institution with an innovative, entrepreneurial approach. In January 2022, Investcorp issued its 2021 Responsible Business Report which outlines its Environmental, Social, and Governance (ESG) highlights for 2021 and specific initiatives the Firm implemented to meet its goals: <https://www.investcorp.com/esg/>

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