Learning Technologies Group (LON:LTG)

SUPPORT

18/10/2016

Overview of Operations

Learning Technologies Group plc (LON:LTG) is an LSE AIM-listed UK based holding company that provides e-learning services with offices in the UK, the US and Brazil and over 200 employees. At the time of this report, there are five main operating businesses: LEO Learning ("LEO"), Eukleia Training Ltd. ("Eukleia"), Preloaded Ltd. ("Preloaded"), Gomo Learning Ltd. ("Gomo") and US based Rustici Software LLC ("Rustici"). LTG also owns a ca. 27% minority stake in the US based company called Watershed Inc. LTG's strategy is to "buy and build" the "best of breed" in the fragmented e-learning market; there are over 3,000 companies in Europe alone. The operating businesses offer various e-learning services, described further below. Financials such as revenues are not broken out by subsidiary in the annual reports.
According to Group Financial Director Neil Elton, likely acquisition multiples would be up to around 10x EBITDA, which corresponds to historical e-learning M&A transactions with EV/EBITDA multiples of low to mid teens. Potential target businesses could provide a mixture of increased technical capability, sector expertise, or increased geographic reach and would likely have an element of recurring revenues and potential for margin improvements. Where targets have strong management and where the owner/founder wants to scale the operations LTG has traditionally offered an element of deferred consideration based on incremental revenue growth. LTG provides the relevant support functions such as Finance, HR, Marketing, Legal and IT to its subsidiaries to liberate them to focus on sales and service delivery, whilst also improving margins through economies of scale. To finance acquisitions, LTG would consider using both equity and debt, although LTG's management would like to limit debt to 2x current EBITDA (ca. £15 million at current levels).

According to LTG CEO Jonathan Satchell, in the e-learning business, the barriers to entry are quite low, and LTG would like to consolidate the industry to become a £50 million revenue company and to create economies of scale. The latest full year (FY 2015) and interim (H1 2016) revenues were £19.9 million and £12.8 million, respectively, and represent revenue growth of ca. 33% vs. FY 2014, and growth of 52% interim 2016 vs. interim 2015. The global e-learning market is forecast to grow by 17% compound annual growth rate (CAGR) by 2020. LEO won a significant contract with Civil Service Learning, ("CSL") together with strategic alliance partner KPMG UK LLP ("KPMG") in December 2015, which could add around £8-10 million of revenue over the 3 year contract term according to LTG's CEO. The government has the option to extend the contract by a further year into 2019. ("CSL") together with strategic alliance partner KPMG UK LLP ("KPMG") in December 2015, which could add around £8-10 million of revenue over the 3 year contract term according to LTG's CEO. The government has the option to extend the contract by a further year into 2019.

FINANCIALS

YE Mar 31	Revenue (£'000)	Operating Profit (£'000)	Operating Margin (%)	Adjusted EBITDA (£'000)	Adjusted EBITDA Margin (%)
FY 2014A	14,920	327	2.2	2,065	13.8
H1 2015A	8,390	317	3.8	1,328	15.8
FY 2015A	19,905	1,768	8.9	4,276	21.5
H1 2016A	12,785	586	4.6	3,247	25.4

SHARE PRICE	52 WEEK LOW / HIGH
32.5p	19p-39p

MARKET CAP	CASH
£135m	£4.26m

NAV	NET DEBT
£31.1m	£9.9M

MAJOR SHAREHOLDERS

1) Andrew Brode – 27%
2) Jonathan Satchell – 25%
3) Liontrust AM – 6%

Shares in Issue	421m
Avg Volume	45,810
Primary index	AIM
EPIC	LON:LTG
Next Key Announcement	Full Year Results
Sector	Support

SHARE PRICE CHART

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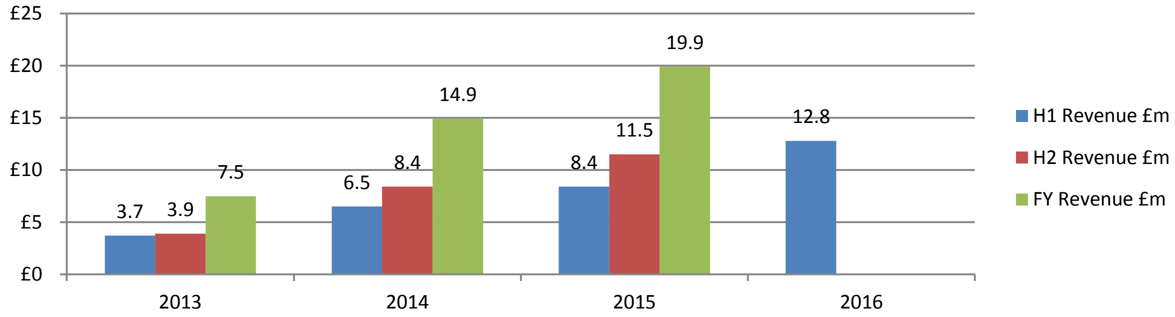
The UK Civil Service comprises more than 400,000 people and CSL co-ordinates the delivery of much of their learning and development. This can be significant as civil servants are targeted to take up to five days per year in training. Revenues earned by the consortium vary according to the type of course being taken, and after payment of third party direct costs, revenues are split between KPMG and LEO, to cover the substantial upfront costs of the developing the curriculum and for ongoing support to CSL. The company has stated that revenues will begin to accrue from Q4 2016 before increasing rapidly in 2017 and 2018.



A positive thing to note is that LTG's management holds over 50% of issued shares and thus should strongly be aligned with the other shareholders, as the company's management is also the majority owner of the business. Furthermore, LTG is paying dividends and has stated that it has a progressive dividend policy; increasing payments as adjusted EPS increases. Dividend cover as a % of EBITDA went from 5.6x in 2014 to 7.1x in 2015, and EBITDA margins increased from 14.9% in 2014 to 21.8% in 2015, and from 15.8% in H1 2015 to 25.4% in H1 2016 as a result of improved working practices, increased economies of scale and an improved revenue mix, including the higher margin licence revenues from the recent acquisition of Rustici. The share of recurring revenues grew from 12% in 2015 to 25% in H1 2016.

Overview of operating divisions and history of acquisitions

LEO is a business unit and brand that was created through a merger of Epic Group Ltd. ("Epic") and LINE Communications Ltd. ("LINE") (founded in 1989), the latter being acquired in April 2014 for £9 million. LINE's founder Piers Lea became LTG's Chief Strategy Officer. LEO provides consultancy lead e-learning solutions for clients including the provision of strategic solutions, content, delivery platforms and analysis. Clients include Jaguar Land Rover, Sky, Novartis, the NHS, MoD, and BP. LEO has offices in London, New York, Brighton, Sheffield, Bloomington (Indiana), and through its JV, Rio de Janeiro and Sao Paulo.

Preloaded provides gamification solutions in the areas of learning, health and training and was acquired in May 2014 for £5.6 million including a contingent deferred earn-out predicated on incremental revenue growth. Clients include companies such as McDonald's, Disney, the BBC and the Science Museum.

Eukleia is specialist financial services Governance, Risk and Compliance (GRC) training consultancy and was acquired by LTG in July 2015 for £11.8 million including a contingent deferred earn-out predicated on incremental revenue growth.

Gomo is a Software as a Service ("SaaS") self-authoring tool that enables creating multi-device e-learning content. Clients include the BBC, Boots, Volvo and the Foreign & Commonwealth Office.

Rustici is the acknowledged expert in e-learning interoperability standards, the protocols that enable e-learning content to communicate with Learning Management Systems (LMSs), the platforms on which e-learning content is accessed. Rustici was acquired by LTG in January 2016 for USD 37 million including deferred contingent consideration. The initial upfront cost of $26 million was part funded by a $20 million loan with an interest rate of USD Libor+2% p.a.. Clients include GlaxoSmithKline, Cambridge University Press, Chipotle, the Navy and the Marines.

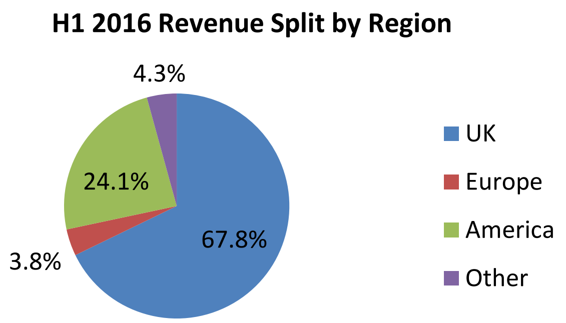
Watershed is a learning analytics platform and was founded by Mike Rustici who also founded Rustici. LTG acquired a 27% stake in Watershed in January 2016 for USD 3 million.

Assuming no impairment and a GBPUSD exchange rate of 1.24, the simple sum of these business valuations is approximately £59 million, which does not take into account any changes in values since the transactions.

Financial results and geographical segment analysis

The majority of the revenues are generated in the UK, although the revenues and percentage of revenues in America grew substantially in H1 2016, presumably due to the acquisition of US company Rustici in early 2016.

Revenues in £'000 by region	UK	Europe	America	Other	Total
H1 2016 (unaudited)	8,669	492	3,077	547	12,785
FY 2015 (audited)	17,528	559	1,638	180	19,905
H1 2015 (unaudited)	7,184	618	570	18	8,390



Valuation

Valuing high growth businesses and businesses with plans for further potential acquisitions such as LTG is always difficult and imprecise, as assumptions regarding the valuation inputs need to be made, which may or may not turn out to be correct. Company multiples are based on current market pricing and company fundamentals such as earnings and are as follows:

LTG's shares are trading at a P/E of around 90 based on 2015 earnings and a forward P/E of around 32, as well as an EV/EBITDA of 30, which is higher than the EV/EBITDA multiples of historic acquisitions in the e-learning space in the low to mid teens, and also more than double that of the Software & IT Services Sector. EV/EBIT is also around 85, so that profitable high growth is needed to bring these multiples down. If management is able to buy businesses at ca. 10 times EBITDA, then these could be earnings accretive depending on the number of shares issued.

Outlook

Half year revenues H2 vs. H1 were 29-37% higher in 2014 and 2015. Assuming an average increase of 33% H2 vs. H1 2016, this would imply FY 2016 revenues of £30 million. For the years 2017-20, if 17% revenue growth is assumed (corresponding to the 17% forecast global e-learning industry CAGR up to 2020), then management's £50 million revenue target would be reached in 2020. With margin improvements of 5-10% vs. 2015 as per management's intention, the P/E could come down to 30-40 in 2017 and to 20-30 by 2019-20. Similarly, assuming a payout ratio as in 2015, the dividend yield could go from ca. 0.5% to 1% in 2017 and around 1.5% in 2019-20 (using the current share price).

Further analysis:

Dilution: The number of shares increased 145% from ca. 276 million in December 2013 to ca. 402 million in December 2015, and further increased in the issued share capital to 413.8 million in H1 2016 basic and 444.3 million on a diluted basis. The reasons for issuing new shares are to acquire new businesses and for stock option based compensation. Stock options only vest based on performance criteria being achieved. LTG's management stated in early October 2016 that they would like to "use equity sparingly" for acquisitions and that the Chairman and CEO do not have stock option based compensation, only outright equity ownership.

Weighted average number of shares 30 June 2016	
Basic	413,821,957
Diluted	444,317,045

Balance Sheet: The assets on the balance sheet tripled H1 2016 vs. H1 2015, and grew over 80% H1 2016 vs. FY 2015, primarily due to the acquisitions of Rustici and the minority stake in Watershed in early 2016. The liabilities increased due to the loan taken to pay for the acquisitions respectively.

	30 June 2016	31 December 2015	30 June 2015
	(unaudited)	(audited)	(unaudited)
	£'000s	£'000s	£'000s
Current Assets			
Cash	4,257	7,305	2,958
Trade receivables	4,177	4,201	3,201
Other receivables, deposits and prepayments	2,194	554	470
Amounts recoverable on contracts	2,914	1,853	2,469
Amounts due from related parties	45	-	-
	13,587	13,913	9,098
Non-current assets			
Property, plant and equipment	796	543	331
Intangible assets	46,496	19,803	11,025
Deferred tax assets	1,094	1,029	825
Investments	1,993	-	-
	50,379	21,375	12,181
Total assets	63,966	35,288	21,279
Current liabilities			
Trade and other payables	9,323	5,835	5,560
Borrowings	2,907	-	-
Corporation tax	162	309	226
Amounts owing to related parties	-	2	
	12,392	6,146	5,786
Non-current liabilities			
Deferred tax liabilities	4,046	1,182	360
Other long term liabilities	5,151	2,382	-
Borrowings	11,145	-	-
Provisions	99	99	30
	20,441	3,663	390
Total liabilities	32,833	9,809	6,176
Net assets (Equity)	31,133	25,479	15,103