

3P Learning Ltd (ASX:3PL)

Reuters	Bloomberg	Exchange	Ticker
3PL.AX	3PL AU	ASX	3PL

Outlook – Cautiously Optimistic

Market Data

Current Price	A\$0.63
Range 52 week	A\$0.62 - 2.45
Vol / Avg.	0.00/916,706.00
Mkt cap	A\$87.6mn
EV	A\$89.1mn
P/E	7.88x
Div/yield	0.02/2.86
EPS	A\$0.08
Shares	139.034mn

Historical Price Chart (1 Year)



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Business Description

3P Learning Limited (3PL) is an Australia-based company, which is engaged in developing, sales and marketing of online educational programs to schools and parents of school-aged students. The Company's programs cover mathematics, spelling, literacy, reading and science.

Industry (Online Education)

The market opportunity for 3PL is very large with a cumulative \$752bn spent on primary and secondary education in 3PL's key markets in 2015. The Global E-learning market is set to grow at a CAGR of >5% for 2015-20 to reach \$220bn in 2020. However, specific segments like mobile learning and game based learning are set to grow at 11.3% and 21.9%, respectively. The US is the largest market opportunity in the operating territories of 3PL.

Outlook

Short term outlook is weak due to events like exit of the long standing CEO and Learnosity acquisition that was heavy on cash balance. However, the long term outlook is promising as the industry is still fast growing in its segments and a shift in the company's strategy to focus on North American market (~54mn students in the US and ~4mn in Canada). We believe that 3PL is appropriately valued at this moment at ~7.43x its FY16E EBITDA shedding the over optimism that it had since the IPO and has potential upside going forward.

Year End Jun 30	2012A	2013A	2014A	2015A	2016E
Sales (A\$m)	28.5	32.0	36.5	44.8	48.0-49.0
EBITDA (A\$m)	3.9	3.5	13.0	16.9	11.5-12.5
Net Profit (A\$m)	2.7	2.7	8.5	10.8	NA
EPS (A\$)	-	-	0.07	0.08	NA
EPS Growth (%)	-	-	-	25.4	NA
PER (x)	-	-	9.30	7.88	NA
EV/EBITDA (x)	22.85	25.46	6.85	5.27	7.43

Source: Company Reports

Industry Overview

Online Education Market overview

The structural migration from printed resources to online content presents a favourable backdrop for the online learning industry. The industry is driven by the following factors:

- The degree of computer and mobile device penetration
- Increasing internet penetration and bandwidth amongst schools and the broader population
- The level of government funding and expenditure
- Consumer disposable income and confidence in key markets
- Availability and quality of online educational content

Online education and learning market is divided in the following segments based on target customers:

- K-12 school system
- Post-secondary, higher and tertiary education institutions
- Corporate e-learning

It can further be divided into following segments based on mode of learning

- Self-paced e-learning market
- Digital reference ware
- Collaboration based learning
- Simulation-based learning
- Game-based learning
- Cognitive Learning
- Mobile Learning

3PL's operates in the K-12 school education segment and offers its products for primary and secondary school students. Its products offer personalized learning environment which engages students through the means of competitions and games. It has both cloud based platform and mobile app.

The market opportunity for 3PL is very large as the cumulative expenditure on total primary and secondary education in 3PL's key territories was \$752bn in 2015 (Finval Research from various government websites¹). This large market opportunity is most pronounced in the US as shown in Figure 1 below. The number of students in its key markets was 86mn in 2014. Again the US is the largest among its operating territories.

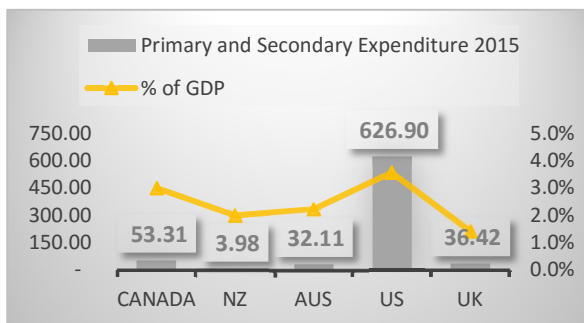


Figure 1 Government expenditure in 2015
Source: Finval Research and government websites¹
Note: Canada data is for 2014

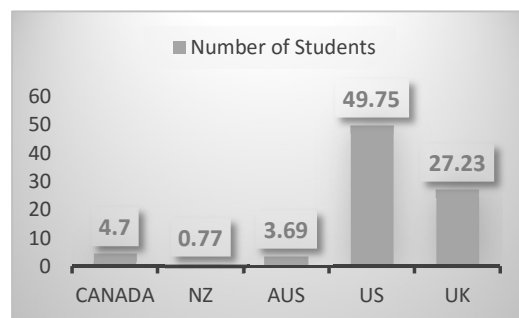


Figure 2 Student enrolment in 2015
Source: Finval Research and government websites²
Note: Canada data is for 2014

More specifically on e-learning markets, the Global E-learning market is set to grow at a CAGR of more than 5% for 2015-20 to reach \$220bn in 2020 (Global E-Learning Market Analysis & Trends - Industry Forecast to 2020 by Accuray Research LLP).

An estimate from Ambient Insight in its report “The 2014-2019 Worldwide Mobile Learning Market” puts the global mobile learning market CAGR at 11.3% from 2014-2019 and it will reach \$14.5bn in 2019. Similarly, global game based learning is set to grow at 21.9% CAGR to reach \$4.9bn in 2019 and simulation based learning to grow at CAGR of 16.8% and reach \$8.3bn (Ambient Insight – 2014-2019 Global game based learning market). While the self-paced e-learning market is expected to grow by only 0.5% CAGR to reach \$47.9bn in 2020 (Ambient Insight – 2015-2020 Worldwide Self-Paced e-learning Market).

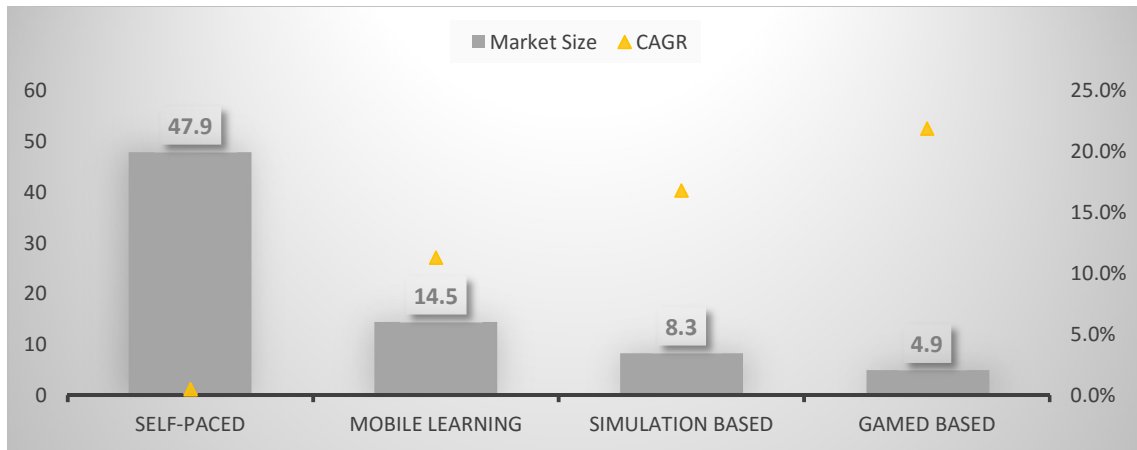


Figure 3 Estimated Market size of key E-learning segments in 2019 and CAGR for 2014-19

The US Market Overview – A significant opportunity

As of 2015, there were about 50.1 million students in the grades K-12 in public schools and another 4.9 million students in private schools. Public school students are expected to reach to 51.1 million in 2020² at a CAGR of 0.5%.

The total US government expenditure on primary and secondary education in 2015 was \$626.9mn (3.5% of GDP) and it is expected to grow at a CAGR of 4.1% to \$799.3mn in 2021¹.

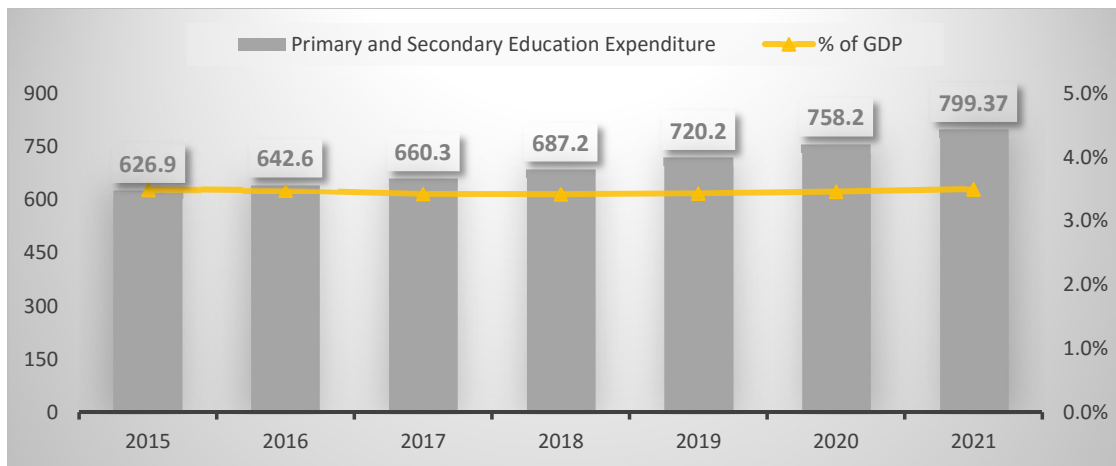


Figure 4 US Government expenditure 2015-21³

The US K-12 IT spends

According to a survey conducted by Center for Digital Education in 2015, more than half of education institutions have done a test drive with digital content; just 22% have a complete strategy for digital transition in place. There is a tremendous amount of opportunity as only 3% have completed the move to an all-digital content and curriculum environment. K-12 education will have an estimated \$11.7 billion to spend on IT in 2016. Major drivers include evolving curriculum and standards as well as the shift to digital education.

Primary areas of focus will be:

- Personalized Learning
- Digital Content and Curriculum
- Online Testing
- Student Data Privacy
- Professional Development

According to a Center for Digital Education survey, teachers and educators identify tablets as the top choice for computing initiatives for grades K-8 while laptop was the top choice for grades 9-12. This provides guidance to the content suppliers on how to target their products. If they are targeting grades K-8 it would be advisable to have a mobile learning platform while for grades 9-12 and higher education, e-learning platforms would be a better option. 3PL is well covered in this regard as it has both the cloud-based platform and a mobile app which students can access from anywhere.

Porter's 5-forces Analysis

Threat of New Entry:

The industry is fast growing and is evolving continuously. Its asset light business model and excess returns are attractive for new entrants. Also, there are no regulations to restrict the entry of new entities.

Supplier Power:

This is a fragmented industry with a large number of players. The key players compete fiercely against each other primarily on product features, technologies and mode of e-learning. The companies have to invest heavily in research and development to release frequent product enhancements and retain market share.

Buyer Power:

As the number of players is large, the bargaining power of buyers is high. Also, in many cases, the customers are public schools funded by local authorities, districts and government, etc. In such cases the companies have to deal with the government and districts and hence the collective bargaining power is high for the buyers.

Threat of Substitution:

The companies in this industry are competing against the traditional content providers and publishing companies. These companies have been providing the content offline which has been the norm so far and is more comfortable for the teachers and educators. Also, in terms of digital education, there are alternative modes of learning like mobile learning, game-based learning, simulation based learning and the companies in these segments compete against each other for market share.

Competitive Rivalry:

There is intense competition in this industry. The competitors are primarily competing on product features, technologies and pricing. It is very important for existing players to continuously innovate and introduce new features frequently. This is further discussed in the competitive landscape below.

[Regulation/policy concerning](#)

Although the industry is not a regulated industry by government norms, it is affected by government policies and actions in the following manner.

- Policy and regulation regarding the collection and storage of student data.
- Any change or revision in curricula may require greater investment in changing the content.
- If the government engages in collective negotiations for public schools instead of the company negotiating with individual schools, it would result in volume offsets and reduction in prices.

[Competitive landscape](#)

Online education resources industry is a highly competitive and fragmented industry. 3PL competes with a wide variety of companies which have exposure to this segment and have access to much larger resources

- **Traditional publishing companies** – Many of these companies are developing online learning offerings or blended learning offerings (which combine books with online). Main companies in this segment are Pearson Group, McGraw Hill, Cambridge University Press, Oxford University Press, etc.
- **Online education resources providers** – Many of these companies are focused on a particular segment, geography or subject area. Companies offer various features like cross curricula content, personalized learning, free or freemium products, etc. Main companies in this segment are Dreambox, Edmentum, Amplify, IXL, Literacy Planet, Blackboard, Skoolbo. These are further discussed in detail below.
- **Large Software companies** – Companies like Apple and Microsoft also offer individual learning tools
- **Education Technology and platform providers** – Companies like Edmodo, Newton, Moodle, Geogebra, Clickview offer cross-curricula virtual learning environments, free or freemium products and are open source.

Competitive Benchmarking matrix

Key Points	3PL	Dreambox	IXL	Literacy Planet	Amplify	Edmentum	Skoolbo
Subject Areas	Math, literacy, Science	Math	Math, Literacy, Science, Social Studies	Literacy	Math, literacy, Science	Arts, Math, Science, ESL	Math, Literacy
Major Geography	Australia	United States	United States	Australia	United States	United States	Australia
Other markets	US, EMEA, NZ	Canada	190 countries	Canada, Europe UK, NZ			US, UK, Singapore, NZ, India, Mexico, Canada
Multiple languages	Yes (2)	Yes (2)	Yes (11)		Yes		
Interactive Style	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Automated reporting	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Years	K-12	K-8	K-12	K-9	K-12	K-12 and higher education	K-4
Pricing	Mathletics - \$99, Reading Eggs - \$80, IntoScience - \$45	\$120 \$25 per student	Individual -\$79. School \$8.30 per student	\$95			Free
Publicly Listed	Yes	No	No	No	No	No	No
Other Info		Chair & co-founder is Netflix co-founder			News Corp. Subsidiary	Offers Reading Eggs products	

Source: Finval Research, Company Websites, Company data

The above list does not capture all the competitors with similar targeted product lines as the industry is highly fragmented and contains a very large number of online interactive offerings. The major competitors to 3PL with similar offerings in the online Math learning category are Dreambox, IXL, Skoolbo, MyMaths and Sumdog. Apart from offering similar features, some of them are cheaper or even offer free products which really intensifies the competition.

Dreambox

Dreambox targets the K-8 demographic with a very similar product offering to Mathletics. Similarities include a highly engaging environment, dynamic questioning according to demonstrated competency and curriculum aligned content. Dreambox products are predominantly sold in the US and Canada,

with low presence in the UK and Australia. For individual and school licenses, Dreambox operates at a higher price point than 3PL as shown in Figure above. Dreambox has also been the recipient of a number of product awards including the 2014 Tech & Learning Award of Excellence.

IXL

IXL targets the K-12 demographic and is a key competitor of 3PL's. IXL possesses similar characteristics to both Dreambox and 3PL; engaging product, dynamic performance tracking and awards upon achievement. IXL is priced at a lower price point than 3PL and operates in more than 190 countries, with the largest presence in the US. The product is used in more than 15,000 schools and covers >2,500 distinct math topics according to the company website. One interesting feature of the IXL product is that students will lose points for incorrect answers. This negative marking may prove demotivating for students, in our opinion. In our view, the quality of the Dreambox product exceeds IXL's and is more closely aligned to Mathletics. This is based upon product characteristics, awards received and user feedback. There also appears a lower learning/teaching component in IXL's product

Skoolbo

Shane Hill, 3PL co-founder and employee until 2008, is the CEO of Skoolbo, another online education competitor to 3PL. Skoolbo offers products in Math and reading subjects for free for life to students, teachers and parents. Given the degree of knowledge regarding 3PL products/strategies by the founder, the risk is that targeted competition increases. It also offers similar features like engaging environment, personalized and dynamic curriculum, games and competitions for students and automated reports for teachers and parents. However, its products are best suited for children up to 8 years of age only.

Literacy Planet

Literacy Planet is a key competitor of Reading Eggs and is predominantly sold in Australia/New Zealand. Investors in Literacy Planet include Ellerston Capital, Map Capital Partners and Intrepica. Literacy Planet offers Literacy products for children from ages 4-15 and provides more than 15,000 literacy games. The concept behind Literacy Planet is quite similar to Reading Eggs in that it is a curriculum aligned, incentives based personalized learning product. The product enables teachers to monitor student aptitude and diagnose areas of weakness.

MyMaths

MyMaths provides interactive and engaging platform for students of all ages. Based in UK it caters to ~4 million students across 70 countries. Its product features are also very similar to 3PL's Mathletics product. But it is costlier than Mathletics with primary subscription at GBP279 and secondary subscription at GBP599 per annum.

Sumdog

Sumdog offers Math, reading and writing products in the UK and the US. It uses educational games to motivate students. It rewards students with a virtual coin for each correct answer with which they can buy goodies for their online avatar created for them. Most of its features are free to use and there is a nominal subscription to use certain premium features.

The Blake Group

The Blake Group competes with 3PL in a number of disciplines within the K-12 segment. Two people associated with the Blake Group, Matthew Sandblom (3PL Co-founder) and Katherine Pike, were

shareholders of 3PL from 2004 until listing and were directors from 2006 and 2010 respectively up until listing. Indeed, a number of the Blake Group's products also retain similar features to 3PL's products. Given the degree of knowledge regarding 3PL products/strategies by the founder, the risk is that targeted competition increases.

Teacher endorsement is the key to entrenching a product within a school. This is due to their input regarding the on-boarding of the company products and particularly their renewal. The company has focused on the value proposition for teachers via a number of means. These include the automatic marking of student course work and the ability to create and share customized course plans which can then be recycled regularly. This ability to create customized re-usable courses increases the commitment to the product and likely the retention rate. These benefits serve to alleviate the teacher's workload and facilitate greater time spent with struggling students.

The large number of players in the industry also provide **opportunities for consolidation**. However, the key concern in the medium to long term is that the industry structure will likely have evolved significantly with **products becoming more commoditized**.

Business Overview

Founded in 2004, 3P Learning (3PL) provides online education resources to school students in grades K-12 across numeracy, literacy and science subject areas. Its main products are as follows:

- **Mathletics** – It is an online numeracy product for grades K-12 and is the flagship product of the company (73% of total revenue in FY15).
- **Reading Eggs Products** – These are online English Literacy products for grades K-6. 3PL has exclusive re-seller rights for these products in Australia and certain offshore territories.
- **Spellodrome** – It is an online English literacy skills product for grades K-10.
- **IntoScience** – It is an online science product that combines simulations, experiments, activities and quests to teach science concepts.

3P is also the creator, host and owner of the World Education Games, which is a substantial global online education event. The event consists of World Maths Day, World Literacy Day and World Science Day and involves students from around the world competing against each other in online challenges across numeracy, literacy and science.

Headquartered in Sydney, Australia, 3PL has presence in Australia, New Zealand, UK, US, Canada, Hong Kong, Pakistan, South Africa and Abu Dhabi.

The company has over 300 employees in 11 countries and reported revenues of A\$44.2mn in FY15.

Product Overview

3PL's product portfolio includes numeracy (Mathletics), literacy (Reading Eggs and Spellodrome) and science (Intoscience) products which are targeted for grades K-12.

All the products are designed and developed to provide the following benefits:

- Improve students' results and ability to learn
- Reduce the workload on teachers
- Personalized learning to individual students
- Swift product enhancements based on user feedback
- Customized lessons by teachers
- Cloud-based platform, dynamic and scalable

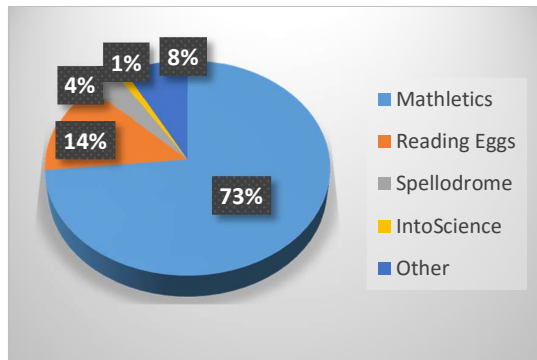


Figure 5 3PL Revenue by Products in 2015
Source: Company Reports

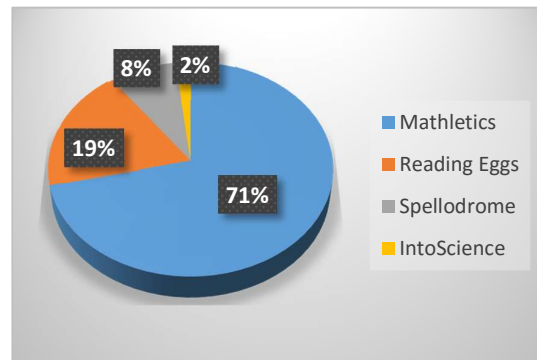


Figure 6 3PL Licenses by Products in 2015
Source: Company Reports

1. Mathletics

This is the flagship product of the company with 73.4% contribution to FY15 revenue. It is an online numeracy product targeted for school grades K-12. It includes the content of 40 curricula around the world and is currently available in two languages (English and Arabic).

It provides a personalised learning environment and questions are dynamically delivered according to a student's responses which ensures the degree of difficulty.

The key attributes from students' perspective are:

- High student engagement through visually guided experience, rewards participation and achievement and competitions amongst students
- Difficulty level of questions is adjusted based on students' responses and demonstrated aptitude which helps to keep the questions challenging
- Aligned to syllabus outcomes.
- Course work or extra learning can be completed during or after school times.

The key attributes from educators' perspective are:

- Automatic marking of course work.
- Ability to customize training courses for small groups or individuals. This increases the retention of products as teachers can recycle/modiFYthe course content year after year.
- Automated reporting of results and up to date records of a student's progress.
- Record retention of student progress.

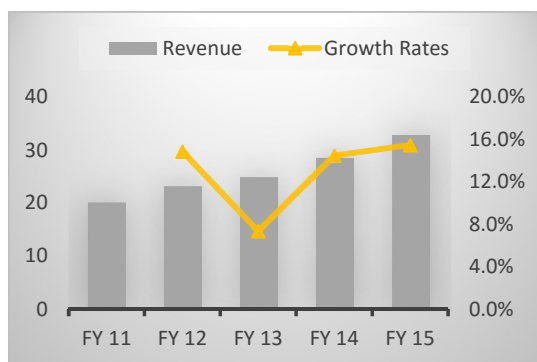


Figure 7 Mathletics Revenue and Growth Rates

Source: Company Reports

Mathletics revenue stood at A\$32.9mn for FY15 with a CAGR of 13.0% over last four years. Mathletics has an impressive market share with penetration in nearly half the schools in Australia and one third schools in New Zealand. It is usually the first product marketed by 3PL when making its presence in any new territory.

2. Reading Eggs

Reading Eggs Products are online English literacy products for school grades K-6 which are developed by the Blake Group. These include Reading Eggs and Reading Eggspress. 3PL has exclusive selling rights for these products in Australia, New Zealand and the UK but not in the US.

Reading Eggs uses a combination of interactive games, songs and animations and is suitable for grades K-2. It is focussed on learning to read and literacy skills.

Reading Eggspress is suitable for school grades 2-6 and is focussed on improving reading comprehension, spelling and other literacy skills of students. It provides access to >1,700 eBooks with associated activities.

3PL pays a royalty of 40% of sales to the Blake group

Reading Eggs products have significant market share in schools in Australia and New Zealand while it has a growing market share in the UK. It reported a revenue of A\$6.2mn in FY15 with a 3 year CAGR of 60.5% and a revenue contribution of 13.8% in FY15. The revenue growth from this product has been very strong in recent years is expected to continue in the future.

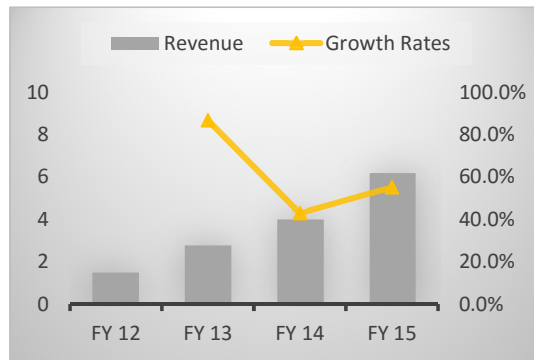


Figure 8 Reading Eggs Revenue and Growth Rates
Source: Company Reports

3. Spellodrome

Spellodrome is also an English literacy product for school grades K-10. It is developed on the same cloud-based platform as Mathletics and is focused on spelling, writing and standardised testing.

It is customizable and teachers can set spelling words and lists to match a class and school's spelling programme. It increases student engagement and motivation by a combination of word games and live competitions.

FY15 revenue stood at A\$1.7mm. At less than 5% of overall revenue, it has remained almost constant for last 4 years. The company has announced that it will not make any new investments in this product and hence it may be replaced by Reading Eggs products in future.

4. IntoScience

It is an online science resource which is recently developed and launched in Australia in FY14. It is currently deployed for school grades 7 and 8 but is intended to expand to entire school grades K-12 over time. It combines high quality experiments, simulations and activities. Video content, games and reward systems are utilised to engage and motivate students.

IntoScience has the potential to achieve first mover advantage since there are few comparable Science programs and the product should benefit from an established sales/distribution network and existing customer relationships with schools and districts.

5. World Education Games

World Education Games is the world's largest online education competition held every two years in association with UNICEF. The event is powered by 3PL's online resources Mathletics, Spellodrome and

IntoScience, which help the students in competing in numeracy, literacy and science domains, respectively. The student registration for this event is completely free.

In the October 2015 edition, over 6 million students joined the event from over 20,000 schools from 166 countries. Students can participate as individuals or as part of an official school team. They compete online in live 60-second challenges of speed and skill through the course of the event. All students receive certificates and awards for their participation, with the top ten students in each age category and event receiving gold medals.

Benefits of the event for 3PL:

- Enhances brand value and awareness about 3PL and its products
- Potential to generate interest from new customers
- Generates sponsorship revenues

Business Organization

3PL has divided its business into three reporting segments based on geographic distribution of its business:

1. **ANZ** – caters to its home market of Australia and New Zealand
2. **EMEA** – Europe, Middle East and Africa
3. **Americas** – includes the US and Canada

ANZ (Australia and New Zealand)

It is the largest segment for the company with contribution of 67% in FY15 revenue and 51% in FY15 licenses. The company has 48% and 44% market share in schools in Australia for Mathletics and Reading Eggs Products in 2014. For students, the market share comes down to 37% and 29% respectively. This indicates that even though the company has significant market penetration in terms no. of schools, it has tremendous scope for growth the number of student licenses through cross selling and bundling of products.

The significant market share also provides the company with the opportunity to effect price increases which is a growth driver in this segment.

EBITDA margins are significantly high in this segment as the company has leadership position in the market.

EMEA (Europe, Middle East and Africa) and Other

The primary market in this segment is UK. The company has its direct sales and marketing team in the UK consisting of 39 people. It also has offices in Johannesburg, Hong Kong, Lahore (Pakistan) and Abu Dhabi. It has developed the Arabic language version of Mathletics for the Middle East market and is also developing a Chinese language version for the China market.

Currently it has only 24% (FY14) penetration in the UK schools and 12% penetration in the UK students with its Mathletics product. For Reading Eggs products, the figures are 4% and 3% respectively.

ARPU in this segment have been continuously increasing for last 5 years. EMEA contributed 24% to FY15 revenue and 32% to licenses. This segment is one of the growth driver for 3PL with primary focus on the UK market.

Americas (US and Canada)

This segment consists of 3PL's operations in the US and Canada. The US is a very large market opportunity as has been discussed in the industry section. The company has covered only about 1% of schools in the US with its Mathletics product. While the revenue growth is healthy in this segment with a 5 year CAGR of 41% up to FY15, this segment has been suffering operating losses primarily due to increased cost pressures (high emphasis on sales and marketing), lower ARPU (low prices due to competitive market).

Business Model

The main streams of revenue are as follows:

- **Student Licences** – This is the primary source of revenue (~91% of revenue). Licences are sold to schools on a per student basis typically for one year.
- **Home Licences** – Licences are also purchased by individual students or parents on behalf of students and not through a school. These licences are sold at higher prices but provide important leads into schools.
- **Other Revenue** – This includes sponsorship, copyright fees and royalty payments from distributors.

All the revenue is primarily received in advance which results in negative working capital but it is recognized equally over the life of the contract.

Key partnership	Key Activities	Value Proposition	Client Relationship	Customer Segment
World Body – UNICEF	Literacy products	Online resources	Varied Pricing	Schools
Technology Partners - Microsoft	Numeracy Products	High level of student engagement	Free product enhancements	Districts
Product Partners – Desmos, Learnosity	Science Products	Reduced workload of teachers	Upselling and cross selling products	Individual students
	Events and Conferences	State of the art technology		Distributors

Key Resources	Distribution Channels	Cost structure	Revenue Structure
Distribution Network	In house sales teams	Employee Cost	Student Licences
Information Technology Infrastructure	Distributors/Agents	Selling and marketing cost	Home Licences
Employees	Online	Technology and Occupancy costs	Sponsorship revenue for events
			Royalty fees

Strategy Overview

There are four main drivers of 3PL's **growth strategy**:

- **Increasing the number of school customers** – It targets to acquire schools which are influential so that their adoption leads to other schools in the area and in the school network to adopt 3PL products. The entry to new markets are facilitated by:
 - **World Education Games** – Enhances the brand of the company
 - **Translation into multiple languages** – Expands reach to non-English speaking students
- **Increasing the number of student Licenses in the existing school customer base** - Some schools start by adopting one of 3P's products for only a few classes as they learn the best ways to utilise the technology before rolling it out more widely across the school. 3PL focuses on leveraging its good relationship with schools for increasing the number of student licenses.
- **Cross sell products to existing customers** – After establishing a strong presence in a territory, the company's strategic focus generally shifts from growing the school customer base in that territory to cross-selling products that pair or bundle together. For example, numeracy and literacy products for primary schools pair strongly together as they are used by the same teachers.
- **Increasing the average revenue per student license** – 3PL believes that it will be able to increase the average revenue per license by increasing the prices on account of increased functionality, utility and continued product development.

3PL intends to continue to focus on organic growth in its operational territories but will also be open to acquiring other online education companies in related fields. Continuing to deliver innovative technology and increase the functionality of its products are integral parts of its strategy.

Americas Strategy

3PL made a specific strategy for the Americas market, which is the largest market in 3PL's operating geographies. Following are the key elements of its strategy:

- To begin with, focus on five major states comprising of 34% of schools in the US. These states are California, Texas, New York, Illinois and Florida.
- In the US, the public schools are aligned to district strategy. Hence, 3PL has the strategy to target districts with a personalized approach as follows:
 - Customized district websites and district level reporting of the students data
 - Printed Success Reports
 - State based branded visuals
- Started off with 2 offices in New York and Calgary. It is now expanding these offices and establishing another in California.
- It is increasing the number of employees in the US. The no. of employees is expected to increase from 41 in 2015 to 62 in 2016.
- Added product features
 - District console in Mathletics
 - Covering curriculum gaps

- Incorporating Desmos graphics calculator
- Incorporating Learnosity assessment tools
- HTML feature in Spellodrome
- Proof of Concept in IntoScience

An analysis of the Americas Strategy reveals that so far the strategy seems to be working for the company with a 5 year CAGR of 39% in licenses for 2011-15 and 42% in revenues. However, the company needs to bring in operating efficiencies in this segment and rationalize the headcount to turn this segment profitable.

Marketing Strategy

3PL has a combination of in house direct sales team and distribution partners. The focus of in house sales teams is:

- Targeting new schools and lead generation
- Renewal of existing licenses and upselling and cross selling products

The sales and marketing team uses a multiple channel approach.

- E-mail campaigns
- Search engine optimisation
- Social media
- Traditional media

Information Technology Infrastructure

3PL's technology infrastructure includes the following

- Multiple data centres spread geographically
- Expected to move to public cloud services
- Partnered with Microsoft for its technology platform.
- Providing single sign on to Microsoft Office 365
- Following best practices in Agile software enables the company to release product enhancements
- Designed to eliminate as many single points of failure as possible via N+1 redundancy design patterns
- Scalable and equipped to support an increase in the number of Student Licences and Home Licences

Advantages of the technology infrastructure to 3PL

- Mitigates impact of failure within a data centre. Backups of databases are made weekly and tested for consistency
- Current system is designed to scale up to 20 million users

Competitive Advantage

Online education resources industry is a highly competitive with a large number of participants targeting the K-12 segment. It competes against traditional print publishers, online education providers, large software corporations, and cross-curriculum platform and technology providers to acquire and retain market share.

3PL expects to successfully compete within its industry and territories based on following factors:

- **Established Distribution Network and existing Customer relationships** – It enjoys the first mover advantage in its home territory of Australia and hence has presence in almost 50% of schools with its Mathletics product. Its IntoScience product also has very few comparable products at this stage and is expected to capitalize the existing customer relationships and established sales/ distribution network.
- **Alignment to international curricula** – Its products are aligned to over 40 international curricula which gives it significant advantage over other products.
- **World Education Games** – Events like World Education Games help to increase the brand recognition of the company. World Education Games (held every 2 years) is the world’s largest event where more than 6 million students participated from 166 countries.
- **Strong IT Infrastructure** – As the company is operating in a fast evolving industry, constant innovation and adding new features to existing products are key to staying ahead of competition. It has partnered with Microsoft for its technology platforms and providing single sign on to Microsoft Office 365. Agile software practices enable the company to release product enhancements and incorporate user feedback in a very short period.

M&A, Strategic Alliances

As part of its growth strategy, the company is open to acquire other online education resources providers and enter into partnerships to enhance the marketability of its products. The company has entered into following alliances and partnerships in the recent past:

1. **Learnosity** – In H1 16, the company acquired 23.07% stake in Learnosity which is a provider of SaaS Assessment Tools and is based in Dublin Ireland. In January 2016, it acquired further 16.93% to raise its overall stake to 40%. The total cost of acquisition was A\$48.5mn in a comprising of A\$33.7mn in cash, A\$8.6mn in shares and A\$6.2mn in deferred payment (to be paid in FY17). Its tools provide following advantages to the company
 - Completely customizable by teachers
 - White labelled solution that is quick and easy to integrate
 - Constant Innovation
 - Integrated future technology roadmap
 - Accelerates 3PL’s core product development particularly for US and secondary school markets
 - Growing global demand for online assessment
2. **Desmos** – In March 2015, the company acquired 17.2% stake in Desmos, Inc. which is a provider of graphics calculator application and is based in the US, for a total consideration of A\$6.5mm. The company also negotiated a commercial distribution agreement which entitles it to use the Desmos tools globally. The investment is not constituted as significant influence over the entity.

SWOT Analysis

Strengths:

Mathletics is its flagship product and is adopted by almost half the schools in Australia. This provides the company with a significant competitive advantage and a degree of pricing power which has enabled it to increase its average revenue per licence in Australia.

World Education Games is a global event which is powered by 3PL's products and is organized in association with UNICEF and partnership with Microsoft. It is held once every 2 years and gives the company and its brands extensive exposure to the prospective clients. It is the largest of its kind in the world and increases brand awareness.

3PL has a very strong balance sheet (negative net working capital and debt free/low leverage) which gives it tremendous room to raise additional capital resources if required.

Weaknesses:

3PL does not own Reading Eggs products and also does not have exclusive selling rights in the US which is the largest market for online resources.

Its America division is continuing to report operational loss due to significant selling and marketing expenditure in the region to establish the company's products in the new territories.

Opportunities:

Student Licences are more concentrated within students in school grades kindergarten to grade 8. Product enhancements and marketing initiatives for senior school grades represent an ongoing opportunity for 3PL.

Growth in Student Licences can be achieved by expanding the target audience for the products. For example, producing content for more advanced students or releasing existing content in other languages.

Threats:

As the barriers to entry are low for the industry, 3PL faces threats from new entrants in the industry who may be able provide better technology and features in products targeted at K-12 segments and have more resources to exploit.

One of the drivers of the growth strategy is improving average revenue per licence by increasing the prices. However, it may not be able to effect the price increase due to competition.

Significant Shareholders

Following are the details of substantial holders of ordinary shares of the company as of 1st June 2016 based on total outstanding shares of 139mm.

Name of the Holder	No. of Shares	% of Total Shares	Current Market Value (A\$)
JP Morgan Nominees Australia Limited	32,408,254	23.3%	20,417,200
National Nominees Limited	27,424,239	19.7%	17,277,271
Citicorp Nominees Pty Limited	17,205,572	12.4%	10,839,510
Pascal Education Services Pty Limited	13,695,000	9.9%	8,627,850
Salt Funds Management Limited	13,416,413	9.6%	8,452,340

Management and Board of Directors

There has been a significant change in the management recently. Tim Power, who has been the CEO of the company for last 10 years, resigned in January 2016 to pursue new opportunities. Tim was replaced by Rebekah O'Flaherty in April 2016. Rebekah has extensive experience in technology companies in the US, Europe and Australia and has led large scale business units for HP, Telstra and Origin Energy.

Other Members of the board and management are as follows:

Name	Designation	Experience
Sam Weiss	Chairman of the Board	He has over 20 years of experience in senior management and directorship with broad industry experience in education, technology and retail companies in Australia, North America, Europe and Asia.
Claire Hatton	Independent Non-Executive Director	She has over 20 years of experience in strategy and operations. She has previously held senior roles at Google Australia and New Zealand – as well as at Plan International Australia and Travelport.
Roger Amos	Independent Non-Executive Director	He has over 25 years of experience in the finance, business and accounting industries. He was a partner at the international accounting firm KPMG for 25 years.
Jonathan Kenny	Chief Financial Officer	He has over 20 years of experience in finance and operations roles for ASX listed and multinational corporations.

Financial Analysis

Income Statement (A\$mn)	FY11	FY12	FY13	FY14	FY15	H1 15	H1 16
Revenue	23.70	28.50	32.00	36.50	44.80	18.40	22.90
EBITDA	-0.20	3.90	3.50	13.00	16.90	6.30	7.30
EBIT	-0.90	2.60	2.20	11.00	13.80	5.00	4.90
NPAT	-1.30	2.70	2.70	8.50	10.80	4.10	3.70
EPS	NA	NA	NA	0.07	0.08	0.03	0.03

Balance Sheet (A\$mn)	FY11	FY12	FY13	FY14	FY15	H1 15	H1 16
Cash and Cash Equivalents	NA	NA	14.78	24.44	30.89	15.80	3.10
Total Assets	NA	NA	35.81	50.57	72.75	48.60	72.60
Borrowings	NA	NA	0.57	0.30	-	-	4.50
Shareholders' Equity	NA	NA	14.49	7.26	33.14	26.90	38.90
Working Capital	NA	NA	4.52	-9.28	4.52	6.00	-13.60

Ratio Analysis	FY11	FY12	FY13	FY14	FY15	H1 15	H1 16
Revenue Growth	NA	19.3%	12.7%	14.1%	22.7%	NA	24.5%
EBITDA Margin	-0.8%	13.7%	10.9%	35.6%	37.7%	34.2%	31.9%
EBIT Margin	-3.8%	9.1%	6.9%	30.1%	30.8%	27.2%	21.4%
NPAT Margin	-5.5%	9.5%	8.4%	23.3%	24.1%	22.3%	16.2%
ROCE	NA	NA	15.9%	72.5%	50.1%	44.1%	19.8%
ROE	NA	NA	18.6%	78.2%	53.5%	48.0%	20.5%
Current Ratio (x)	NA	NA	1.22	0.78	1.13	1.31	0.47
Debt/Equity (x)	NA	NA	0.04	0.04	NM	NM	0.12
Debt/EBITDA (x)	NA	NA	0.16	0.02	NM	NM	0.62
Free Cash Flows (A\$mn)	-3.90	3.90	4.50	9.00	11.60	-6.10	-10.10
Working Capital (A\$mn)	NA	NA	4.52	-9.28	4.52	6.00	-13.60

Revenue has steadily increased at a CAGR of 17.3% from FY11 to FY15 on the back of healthy growth in EMEA and America segments and modest growth in ANZ (contributed 67% in FY15). In FY15 revenue was up by 22.7% to A\$44.8mn primarily on account of price increase in ANZ segment (12-15% price increase) and growth in number of licences in the EMEA and the Americas segments.

For H1 16, overall revenue was up 24.5% on the back of 57.9% and 52.4% growth in America and EMEA segment and increase in ARPU in ANZ and EMEA segments. Americas continued to face downward pressure on ARPU as the company has kept the prices low to penetrate the market.

EBITDA margin jumped in FY14 as compared to FY13 due to a change in policy by the company. From FY14, the company started capitalizing the development cost of its products and amortize it over a period of 5 years. As a result of this, employee cost decreased and D&A increased. Excluding the effect of policy change, EBITDA margin for FY14 and 15 was 18.1% and 18.8%, respectively. The improvement over previous years was on account of growth in revenues of 14.1%.

EBITDA margin for H1 16 dipped primarily on account of higher selling and marketing costs due to increased sales initiatives in EMEA and America and costs related to WEG held in October 2015.

The fluctuations in ROCE and ROE are primarily on account of dip in Shareholders' Equity in FY14 due to special dividend given before the IPO and raising additional funds in the IPO. Excluding the impact of special dividend, ROE is ~40% in FY15. ROE dipped to 20.5% in H1 16 due to lower PAT and also issue of new equity in Learnosity transaction. High return ratios are evident of the asset light model and excess returns in the industry.

The company has primarily been a debt free company. It has negative net working capital as revenue is received in advance and hence substantial deferred revenue is created. Cash flows are ahead of revenue.

As per the **trading update** released on 1st June 2016, revenue growth is expected in the range of A\$48.0mn to A\$49.0mn (up 7-9% YoY) and EBITDA to be in the range of A\$11.5mn to A\$12.5mn (down ~26-32% YoY). The competition has intensified which has led to lower retention rates in the secondary school segment in ANZ region.

Investment Thesis

The surprise exit of the long standing CEO has not been taken well by the market. This was followed by not so good earnings reported for H1 2016 and a trading update indicating a damp FY16. The Learnosity acquisition was a run on the cash balance of the company and the company abstained from paying any interim dividend. All these events have dented the sentiment and dragged the stock down by ~65% YTD.

It will be a challenge for the new CEO to revive the growth in the highly competitive market. However, the company is in a fast growing but fragmented industry and has global brands and distribution network. 3PL has the right strategy to focus on the US market being the largest market in its operating territories. Once it is able to gain market leadership in US, it will be able to use its pricing lever to generate high cash flows.

We believe that 3PL is appropriately valued at this moment at 7.43x its FY16E EBITDA shedding the over optimism that it had since the IPO and has potential upside going forward.

Key risks to our Investment Thesis

- It does not have exclusive selling rights for the Reading Eggs products in the US
- It may not be able to use the pricing lever to improve its margin due to competition
- The technologies and features it incorporates are fast evolving and can be replicated by other providers which reduces the competitive advantage

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