



● ● ● ● Further and Higher Education
● ● ● ● Market Review
● ● ● ● Spring 2018

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Gambit Corporate Finance

Established in 1992, Gambit is an independent corporate finance firm specialising in advising private and public organisations on mid-market transactions in the UK and overseas. With offices in London and Cardiff, Gambit is widely recognised as a market leader in corporate finance advice having built up detailed industry knowledge and an enviable track record in deal origination, financing and execution.

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Jason Evans
Partner, Debt Advisory

Jason Evans is the partner that leads Gambit Corporate Finance's Debt Advisory team. Prior to joining Gambit, Jason was Regional Director for Lloyds Banking Group, heading up the regional corporate banking team in the Mid-Market and working with organisations with turnover between £10m and £750m.

After graduating from the University of Reading in 1991 with an honours degree in economics and accounting, Jason began his career at Coopers & Lybrand Deloitte. During his 25-year career, Jason has held various senior roles, including Divisional Head of Leveraged Finance for HSBC.

He is also an Associate of the Securities and Investment Institute, holding an advanced corporate finance qualification from the Institute of Chartered Accountants in England and Wales (ICAEW). Jason has also been voted "Corporate Banker of the Year" on a number of occasions at the Insider Dealmaker Awards.

Executive Summary

Macroeconomic Overview:

The global economy is growing at its fastest pace in seven years. Global output is estimated to have grown by 3.7% in 2017, with forecasts for 2018 and 2019 revised upward to 3.9%. MPC predictions signal a buoyant UK economy, as UK GDP growth is expected to average 1.8% per annum from 2018 – 2021, ahead of estimates of potential growth of 1.5%.

Inflation has been above the 2% target over the past year due to a sharp fall in sterling, triggered by the EU referendum. This has increased speculation of a tightening of monetary policy during 2018.

Despite Brexit concerns, unemployment levels reached a 42 year low of 4.3% in 2017. Based on the Q4 2017 Bank of England Summary of Business Conditions, investment intentions remain consistent with modest growth.

- Traditional high street banks remain active in providing debt to the sector. However, tenors have become shorter and EIB funding has declined.
- Interest rates are expected to continue rising gradually across major economies, but remain very low by historic levels - implementing a strategy in the shorter term is likely to be constructive, particularly for longer term funding.
- The full implications of Brexit on Institutions and markets is unclear and those with refinance dates either side of Brexit, may want to consider accelerating the process.
- A wall of liquidity is currently available in credit markets, looking to be deployed by an ever increasing range of institutions – it is important to consider the full range of debt options.

In Summary – Higher Education

The financial performance of the Higher Education sector overall has been relatively stable, despite the increasing variability in the performance of individual Higher Education Institutions (HEIs).

Sector surpluses have been inflated by transitional accounting changes, such as the change in recognition of capital grants and an increase in pension provisions.

Welsh Universities overall have seen a decrease in the number of applicants from the 2016 cycle, as more school leavers enter the likes of apprenticeship programmes.

Universities continue their major contribution to the UK economy, with Welsh universities generating £5 billion of output in Wales in 2017 and creating nearly 50,000 jobs.

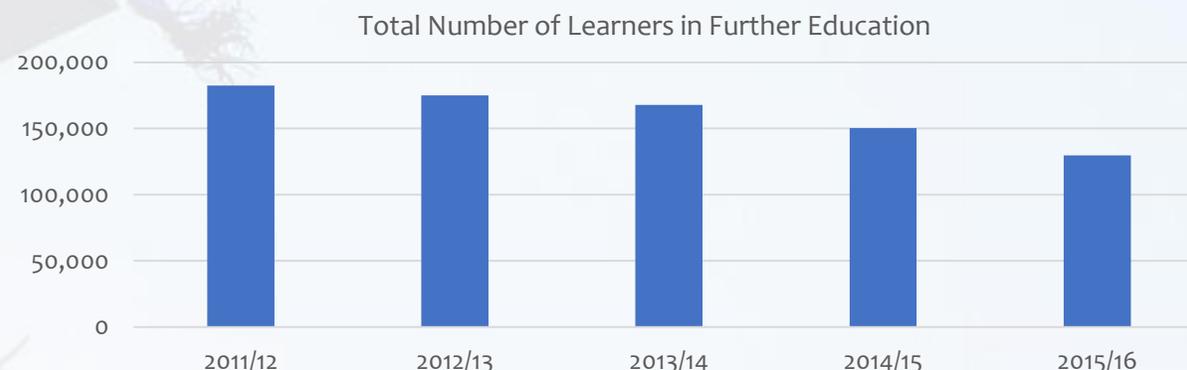
The short term decline in the population of 18-year-olds, the potential impact of Brexit on student recruitment, and the increasing availability of alternative post-18 educational options, has resulted in an increasingly competitive and challenging Higher Education environment.

In Summary – Further Education

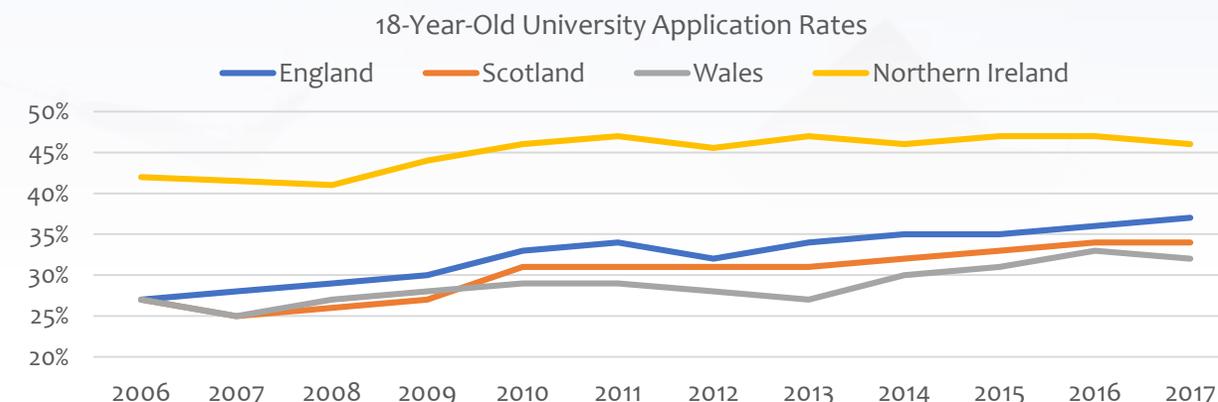
Welsh colleges have attempted to address reductions in income by reducing expenditure, although deterioration in financial performance has still been experienced as reflected in an overall deficit of £1.7m in the sector.

The proportion of the Further Education Institutions' (FEIs) capital expenditure financed by Welsh Government grants has tended to decline in recent years, leading to an increasing reliance on colleges own reserves and borrowing to fund capital expenditure.

Consolidation between education providers has been prominent in the FE sector in Wales, due to the impact of the Welsh Government's Transformation Programme.



Source: Welsh Government Statistical Release, Further Education, Work-based Learning and Community Learning in Wales



Source: Universities UK – Higher Education in Facts & Figures

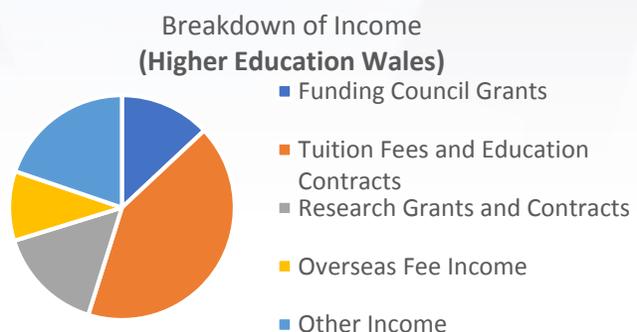
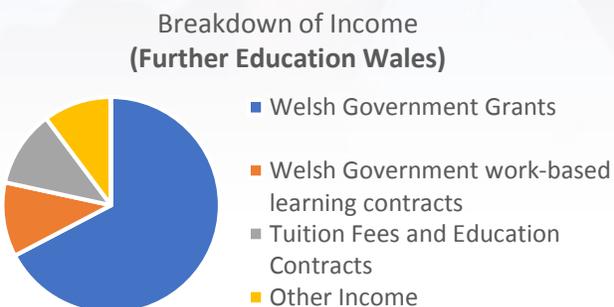
Financial Performance

Higher Education

- The Welsh Government’s Higher Education budget has seen seven successive years of cuts. The 2017-18 budget stands at £104.4m, down from £117.8m in the previous year. A shift in focus from grant funding to full-time undergraduate fee income **leaves those Universities with a higher proportion of part-time provision particularly vulnerable**.
- Overall, the HE sector has demonstrated improved financial performance, recovering from a deficit of £5.5m in 2014-15, to a surplus of £74.8m in 2015-16.
- Financial health varies at an institutional level, from a deficit of 7.3% of total income to a surplus of 17.5% (2015-16) as the gap between the lowest and highest performing institutions continues to grow.
- Transitional accounting changes, such as the change in capital grant recognition and an increase in pension provisions, have **inflated sector surpluses**. For example, capital grants, now recognised as income, have contributed £48.8m to sector surpluses.

Further Education

- The Welsh Government has cut revenue grant funding for the Further Education sector by **£22 million over the past 5 years - a reduction of 13% in real terms**. Funding for full-time provision has, however, increased by 3% in real terms, compared to a drop in funding for part-time courses of 71%.
- This has driven a reduction in Further Education sector net income of 10.8% in real terms over the same period.
- Colleges have attempted to address reductions in income by reducing expenditure, although deterioration in financial performance has still been experienced - as reflected in an overall deficit of **£1.7m in the sector**. The decline in Welsh Government grant funding has not been matched by an increase in alternative sources of income.



Source: Welsh Government oversight of further-education colleges’ finances and delivery

Source: Financial position of higher education institutions in Wales

Capital Expenditure

Higher Education

- Overall, levels of capital expenditure have predominantly been financed by debt, as HEIs committed to new borrowings of **£353m during 2015-16**. Capital expenditure is forecast to grow in order to meet increasing competition, student expectations and fund research and innovation infrastructure. **Organisations should consider the options available when raising additional debt to select the most appropriate instrument and structure.**
- Until recently, **Welsh universities have had lower borrowing levels than the UK sector average**. However, forecasts predict that increases in borrowing to support significant development plans are likely to result in Welsh sector borrowings matching that of the UK.
- **Confidence is high amongst investors, including banks, who continue to lend to the sector**, although traditional banks have shortened tenors.
- Long term external borrowing and obligations under finance leases increased by 228% to £714m in July 2016, predominantly through Cardiff University’s bond issue.
- A recent report by Universities Wales suggests evidence of an **ongoing need for further capital investment** in the sector in order to compete in an increasingly challenging environment.

Further Education

- Overall, Welsh Government funding to support FEI capital expenditure has dropped from an average of **£34m per annum in 2011 to £17m in the subsequent five-year period**.
- The proportion of FEIs capital expenditure financed by Welsh Government grants has also declined in recent years, to an average of 29%. As a result, **FEIs are becoming increasingly reliant on their own reserves and alternative sources of funding. The availability of alternative finance and low interest rates indicates an opportune time for organisations to consider all options available.**
- The Welsh Government continues to support several major projects through the ‘**21st Century Schools and Education Programme**’, comprised of a £1.4bn first round investment throughout all 22 Local Authority areas in order to rebuild and refurbish schools and colleges.
- The first round of 21st Century Schools and Education Programme was predominantly focussed on addressing schools’ infrastructure issues. **Welsh FEIs did, however, benefit from £38m of grant funding for 5 projects**, including Cardiff and Vale College’s city centre campus in Cardiff.
- Colleges will soon be able to bid in the second round of the programme, covering the period 2019-2024. **Early identification and professional proposals to put forward a compelling business case is key to success.**

International Relations

- The UK benefits significantly from EU funding injections and contributions from international students, who boosted the UK economy by £20bn in 2017 - 10 times more than the cost of hosting them.
- Potential reductions in EU funding and international student application rates, as a result of Brexit could substantially impact education providers' income streams and levels of capital expenditure.
- Reductions in funding have already been experienced as the EIB halted the financing of a billion pound funding programme for UK schools, hospitals and social housing.

Higher Education

- Welsh universities attracted more than 22,190 international students from outside the UK last year, earning institutions £1.51bn in institution fees, HEFCW grants, research grants and other contracts.
- In addition to general funding, of which 15% comes from the EU, the UK receives substantial financial contributions to research in universities amounting to around £1bn per year. The European Structural Fund represents the main source of capital and innovation funding for Wales, awarding £240m to Welsh universities for 2014 - 2020. Swansea University, for example, recently opened a new science and innovation campus at a cost of £475m with the help of EU backed funding.
- Education providers are uncertain of how these relationships will continue post Brexit and it is for these reasons that The Russell Group is working closely with the government to ensure that universities and the research community receive the best possible outcome from the negotiations to leave the European Union.

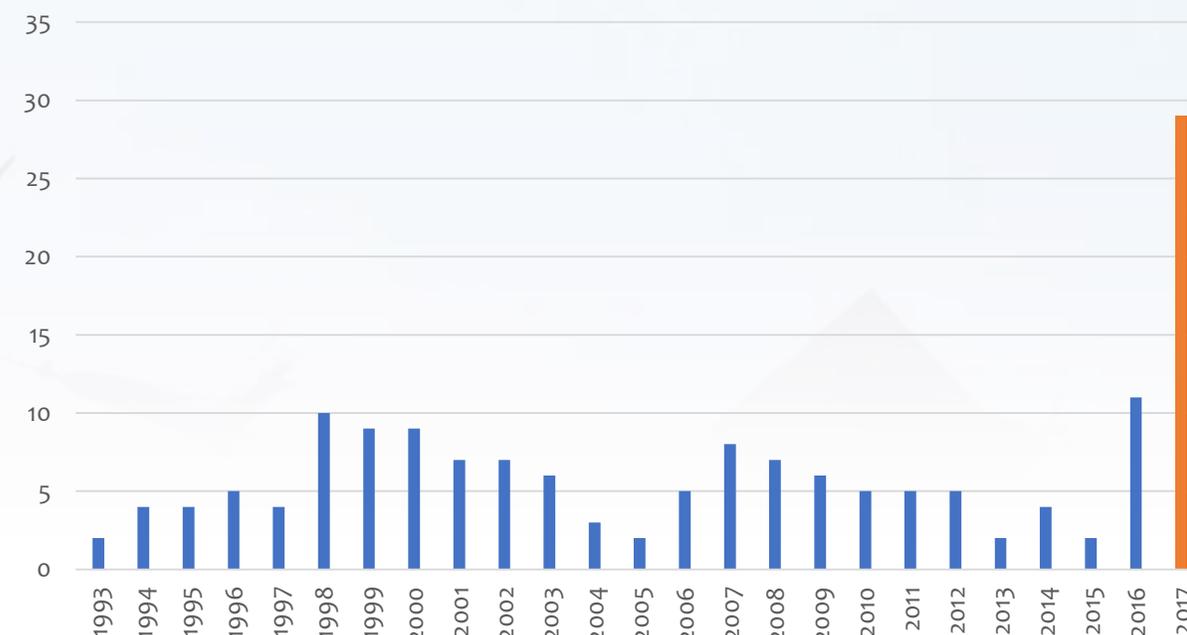
Further Education

- Further Education colleges across Wales have been involved in the delivery of EU-funded projects to a total value of nearly £600M over the past 10 years.
- The European Social Fund has been a significant source of income for the FE sector. Programme funding is projected to rise over the next year, to £11.6m until 2020. European Social Funding, however, will come to an end once the UK leaves the European Union.

Consolidation

- Consolidation and collaboration between education providers has been a prominent feature of the Further Education sector in Wales. Between September 2008 and August 2015 the number of colleges in Wales reduced from 25 to 14.
- Consolidation has largely been due to the impact of the Welsh Government's Transformation Programme.
- Consolidation and collaboration between education providers in England has also increased in recent years as there are currently 280 Further Education and sixth form colleges, compared to almost 450 when colleges were incorporated in 1993.
- 2017 saw the largest amount of consolidation between colleges, as 29 Further Education mergers took place in England. Of the most notable mergers was London's biggest college group, The Capital City College Group, who further expanded through a merger with College of Haringey, Enfield and North East London.

Number of Further Education mergers: 1993 – 2018 (England)



Source: Association of Colleges

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- Succession Planning
- Debt Advisory
- Research and Deal Creation

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