Dodgy VET Companies Crash and Burn

I have always said there is a price for everything. Having met with **Australian Careers Network** (ACN, ASX ticker is ACO) this year, I can no longer make that statement. We walked out of a meeting with Managing Director Ivan Brown in September and I told colleague Alvise Peggion we're not touching the stock, at any price.

Broker Petra Capital had been harassing us for months to take a look at the company. Post its 2015 results, the company was trading at 10 times historical earnings and 6 times forecast earnings, an obvious bargain price for a business growing like wildfire.

Something didn't smell right, though. Not with the entire VET industry and not with Brown's Australian Careers Network in particular (VET is short for vocational education and training). The business didn't exist at the start of 2012. In fact, Brown had only left his job as a policeman in 2009, aged 30. By September 2015, when he and Petra came to visit us, the company was listed on the ASX, had a market capitalisation of $240m and Brown had made his way on to the BRW Young Rich List. All of this with less than $5m in net property, plant and equipment.

We live in the age of unicorns, of course. There is apparently nothing unusual about a thirty-something year old making tens of millions of dollars in a few short years. But this is not some tech startup. It is an old fashioned teacher-to-student education business. And it is completely dependent on the government for its revenue. How does a business like this go from zero to more than $100 million of annualised revenue in three short years?

To provide the backdrop, it all started when the Victorian government tried to reform the vocational education industry. The idea was to save the state money by making the old government Technical and Further Education (TAFE) colleges compete with new entrants from the private sector. Historically students were required to pay around 20% of the cost TAFE course upfront in cash, and the government funded the remaining 80% or so. The reforms the government introduced allowed private colleges to provide TAFE courses, with the government paying the same dollar amount they would have paid TAFE. Crucially, the private colleges were free to charge students what they liked. All you needed was to be a registered training organisation and have a funding agreement.

The idea was to motivate the competitors, and boy did it motivate the private sector. But perhaps not in the way envisaged. Many private colleges worked out they could run these courses profitably with no upfront contribution at all from the student. That made it pretty easy to persuade students to enroll in courses they mightn't be well suited for, or inspired to actually complete, because after all there was no downside to the student. Student enrollments through the private colleges promptly soared, and allegations of rorting soon surfaced, including shoddy teaching standards, poor course content and even incidents of students being offered free iPads to enroll.

It's in this environment that ACN had grown so rapidly. And I got a few hints on how it had done so in the meeting with Brown (let's just say they didn't increase my confidence levels). But now that the 2015 annual report is out, I can show you how it happened with some numbers.

On 13 January 2015, ACN announced the acquisition of the Phoenix Institute of Australia. Here's an extract from the announcement:

> Over the last 15 years, Phoenix has delivered programs in holistic counselling and art therapy for people wishing to work in the health, education and community services sectors. Phoenix offers the VET programs, Diploma of Transpersonal Counselling and the Diploma of Transpersonal Arts Therapy. Phoenix also is a Higher Education provider offering the Bachelor of Holistic Counselling and has contracts to offer courses under both FEE-HELP (Higher Ed) and VET FEE-HELP (VET).
>
> The acquisition of an RTO with VET FEE-HELP provides the opportunity for ACN to add further courses to Phoenix's current scope of delivery in areas of current need for clientele of the greater ACN group and the Board believes it provides material upside for the ACN group.
>
> The projected EBIT is $575K and it will be earnings per share accretive in the current year.
>
> The terms of the agreement are for an initial payment of $2.25 million on completion and a further payment of a maximum of $2.25 million over 3 years based upon the future profit ($575K year 1, $840K year 2 and $840K year 3) generated from the current programs meeting forecasts provided by Phoenix. Any new programs or courses activated by ACN will not be taken as attributable to such forecasts. The agreement was subject to a number of pre-conditions including completion of satisfactory due diligence by ACN.

Fair enough, I guess. Here is a business that has been around for 15 years, providing "holistic counselling and art therapy" courses (what, exactly, is "art therapy"?). It had probably grown slowly and, by the time ACN turned up on the door-step, it was generating $575k of annual earnings before interest and tax. ACN agreed to pay $4.5m, half of which was dependent on future performance.

Note 24 to the 2015 annual report shows us what happened after ACN bought Phoenix:

> **iv. Phoenix contribution to the Group's results**
>
> Phoenix contributed $56,040,000 and $11,200,000 to the Group's consolidated revenues and consolidated profit, respectively from the date of the acquisition to 30 June 2015. Had the acquisition occurred on 1 July 2014, the Group's revenue for the period to 30 June would have been $1,700,000 higher and Group's profit would not be materially different to the amount reported.

So they bought Phoenix on the 13th of January. In the period between 1 July 2014 and 13

January 2015, it generated just $1.7m of revenue. In the post-acquisition period, 13 January to 30 June the same year, it generated an astonishing $56m in revenue. Better yet, the profit from that six-month period was almost three times the acquisition price.

Either these guys are the world's best business operators, or there is something very dodgy going on.

Brown explained to me in September that they had a few more small acquisitions lined up, "each of which was going to add $5m-10m EBITDA to the business". When I asked why anyone would sell a business for a few million dollars if it was going to make more than that in one year, he explained to me that they aren't buying businesses, they are buying access to the funding agreements, the agreement that ensures the government will pay them to enrol students. I'm paraphrasing here, but the key comment was that "our large student database allows us to funnel significantly more students down the pipe".

It finally all clicked into place. They have a massive database of students and a network of brokers who feed them students. ACN goes and buys small businesses that have funding agreements and have been providing courses to a small number of students for years, then they shovel thousands of students into the courses and collect millions of dollars of funding from the government.

Brown maintains the courses and students are all legitimate. State and federal governments and the ACCC all seem to have a different view of the matter. Phoenix has been deregistered as a training organisation, making it ineligible for funding, and the ACCC and Commonwealth have commenced legal proceedings against the company.

Fellow ASX-listed VET company Vocation filed for voluntary administration today, with investors refusing to cough up for a capital raising. And the front page of the Australian suggests these types of companies are going to be shut down for good. Not a minute too soon. Hundreds of millions of dollars of taxpayer money have been wasted, not to mentioned a few hundred million of investor cash to boot.

**ACN co-founder Prakash Charan cashed out in the IPO, collecting $36.55m in a well-timed exit. Ivan Brown sold $2.85m worth in the float, part of which was used to fund broker fees relating to the listing, but kept the rest of his holding.*