NMT Nursery Estate, Acquisition & Expansion Forum

Overcoming challenges and opportunities for growth

Arun Kanwar, Partner

6th March 2019
Big issues in the nursery market

- Schoolification of nurseries
- 30h funding
- Ability to increase fees
- Economic Uncertainty
- Pricing of acquisitions
- Staff recruitment
- Staff costs
- Brexit
- Business rates
- Economic Uncertainty
- Staff costs
Despite the uncertainty in the market, there is still optimism

### Like-for-like Enrolment growth

<table>
<thead>
<tr>
<th>Historic (last 3 years)</th>
<th>Expected (next 2-3 years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>29%</td>
<td>13%</td>
</tr>
<tr>
<td>29%</td>
<td>50%</td>
</tr>
<tr>
<td>43%</td>
<td>31%</td>
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</tbody>
</table>

### Price growth

- **Same rate as before**: 44%
- **At inflation/ below inflation**: 56%

#### London/SE vs other:
- Groups in London/ South East expect lower growth enrolment growth, but higher ability to increase fees

#### Large vs small groups:
- Larger groups experienced lower enrolment growth but predict higher ability to raise fees in the future
Consensus that staffing is the most key issue in the sector

Key issues faced in the UK Early Years sector

- Recruitment of staff: 71%
- Increasing staff wages: 29%
- Schoolification of nurseries: 18%
- Implementation of 30 hours: 35%
- Sustainability of price increases: 31%
- Sustainability of parent demand: 6%

Not an issue: 13%
Minor issue: 50%
Quite an important issue: 19%
Important issue: 13%
Critical issue: 6%
The recruitment crisis is easing (but still challenging) ...
... you have several strategies to deal with the staffing issues ...

<table>
<thead>
<tr>
<th>Strategies from Cairneagle’s survey providers¹</th>
<th>Strategies from CEEDA’s nursery survey providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing salaries</td>
<td>Asking staff to recommend jobs</td>
</tr>
<tr>
<td>Use of bank staff</td>
<td>Recruiting based on potential but not experience</td>
</tr>
<tr>
<td>Non-salary retention strategies</td>
<td>Upskilling existing employees</td>
</tr>
<tr>
<td>Use of apprentices</td>
<td>Apprenticeship schemes</td>
</tr>
<tr>
<td>Use of agencies</td>
<td>Increasing use of overtime</td>
</tr>
<tr>
<td>Hiring degree level qualified staff</td>
<td>Employing bank staff</td>
</tr>
<tr>
<td></td>
<td>Employing agency staff</td>
</tr>
<tr>
<td></td>
<td>Offering higher salaries</td>
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<tr>
<td></td>
<td>Paying for professional qualifications</td>
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<tr>
<td></td>
<td>Recruiting overseas</td>
</tr>
<tr>
<td></td>
<td>One-off payment for joining</td>
</tr>
<tr>
<td></td>
<td>Recruiting from other sectors</td>
</tr>
</tbody>
</table>

55%  50%  44%  38%  37%  29%  23%  22%  22%  8%  7%  5%

Source: Cairneagle analysis, CEEDA nursery survey of day nurseries, 2018
1. A ranking score was applied to responses to this question
OVERCOMING CHALLENGES AND OPPORTUNITIES FOR GROWTH

.... but Brexit poses a risk to this

<table>
<thead>
<tr>
<th>Brexit impact on enrolment</th>
<th>Brexit impact on recruitment</th>
</tr>
</thead>
<tbody>
<tr>
<td>As experienced</td>
<td>As experienced</td>
</tr>
<tr>
<td>100%</td>
<td>13%</td>
</tr>
<tr>
<td>Expected</td>
<td>Expected</td>
</tr>
<tr>
<td>88%</td>
<td>88%</td>
</tr>
</tbody>
</table>

EU staff make up 5.1% of all childcare staff nationally. Possible post-Brexit preference for ‘high skills’ jobs

Don’t know  Negative  Neutral
30 hours has been mostly managed by commercially minded operators.

How do you offer 30 hours?

- **Not free at the point of delivery**: 76%
- **Free at the point of delivery**: 24%

Mitigation strategies when not operated free at the point of delivery:

- **Stretched over the full year**: 65%
- **Limited free entitlement places**: 59%
- **Charging additional extras (e.g. lunch)**: 59%
- **Wrap-around**: 35%
- **Charge supplements on funded hours**: 35%

30h funding still presents a challenge because funding rates may remain static over the next couple of years, resulting in lower achieved blended price increases or above-inflationary price increases which will need to be passed on to parents.
Focus on improvement

Priorities to optimise current nurseries

- Better enquiry mgmt.
- Better Marketing
- Invest. in facilities
- Invest. in teacher training
- Fee increases
- Invest. in resources
- Nursery-level cost control
- Central office cost control

Priorities for technology investment

- Electronic parent communication
- E-learning
- Invoicing and accounting
- Electronic ERP
- Electronic learning journals
- Electronic sales CRM
Looking to the future – still significant M&A opportunities

What are your priorities in terms of expansion?

<table>
<thead>
<tr>
<th>Priority</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK site acquisitions</td>
<td>45%</td>
</tr>
<tr>
<td>UK site openings</td>
<td>32%</td>
</tr>
<tr>
<td>Capacity extension of existing nurseries</td>
<td>16%</td>
</tr>
<tr>
<td>International expansion</td>
<td>5%</td>
</tr>
<tr>
<td>Franchising in the UK</td>
<td>3%</td>
</tr>
<tr>
<td>No expansion planned</td>
<td>0%</td>
</tr>
</tbody>
</table>

Market share of the top market participants by sector

- **Children’s nurseries**: 75%
- **Veterinary**: 65%
- **Dental**: 60%
- **Funerals**: 55%

Other providers and other sectors.
Pricing has become an issue, but we may be reaching ‘peak pricing’

According to Christie & Co, prices increased by 9.7% in 2016, 10.8% in 2017 and 8.0% in 2018.
Finding the right assets is often an obstacle

Is availability of assets an obstacle to acquiring?

Key strategies identified to overcome challenges

1. Look for deals off market
2. Network with agents or introducers
3. Unlock turnaround opportunities (quality and financial)
4. Target unexploited areas of demographic and socio-economic growth

Key issues highlighted include portfolio fit and issues discovered in due diligence
### International expansion options

#### Direct investment
- **Nursery provider**: Direct financial investment and mgmt.
- **Overseas nursery**: 100% nursery surplus

#### Management contract
- **Nursery provider**: 100% working capital
- **Operating company**: Brand + mgmt. oversight
- **Property company**: 100% investment capital

#### Joint Venture
- **Nursery provider**: Share of nursery surplus
- **Local investor**: Brand + mgmt. oversight
- **Operating company**: 100% investment capital
- **Property company**: Nursery premises lease

#### Franchising/Licensing
- **Nursery provider**: Royalty fee
- **Local investor**: Brand + mgmt. input
- **Operating company**: 100% working capital
- **Property company**: Nursery premises lease

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**Source**: Department for International Trade

*Higher P&L ownership but less likely to be implementable in certain developing countries.*

*Lower return but also less risk due to lower involvement.*

*Perhaps more appropriate for developing countries.*
About Cairneagle and its education practice

- Cairneagle, founded in 2001, has grown to be a leading independent strategy consultancy specialising in Education and Media / Technology.
- Education makes up over 80% of our practice and we have conducted around 150 projects in this space.
- We support strategic decisions that Chief Executives and Boards of educational institutions and companies supplying services to the sector, as well as private equity firms, have to make by bringing structure, insight and judgement to situations of uncertainty and material financial impact.
- Approximately 50% of our work is international in character, split between helping UK clients internationalise and working for overseas clients.
- We are a firm of three highly involved partners and one principal, supported by a core team of talented and capable consultants. A team of experienced senior advisors supplements as appropriate.
- We have built a strong reputation for our rigorous, data-driven approach, our analytical audacity and our determination to add value for our clients.
- Our expertise and continued focus on Education were recognised both in 2015 and in 2016, when we have been selected as winners of EducationInvestor’s award for consultants to the private sector.

What EducationInvestor's judges say about us

- “An excellent submission showing how they can adapt to a variety of project types and add value”
- “[Recommended] for their emphasis on accountability and affordability”

What our clients say about us

- “What struck me about Cairneagle's research was the maturity of their interpretation and the independence of their thinking. They push beyond common collective views and deliver true strategic insight.”
  
  Content and Business Strategy Director, Leading Global Publisher

- “We worked with Cairneagle to evaluate a portfolio of assets coming for sale in the education sector. The team at Cairneagle went above and beyond what they had promised us and gave us deep insight into the opportunity”
  
  Principal, Sovereign wealth fund
ABOUT CAIRNEAGLE

Cairneagle Associates

18
YEARS FOCUSED ON QUALITY AND DELIVERING VALUE FOR MONEY

100+
PROJECTS IN EDUCATION OVER THE LAST 12 YEARS

50%
INTERNATIONAL WORK

2
TWICE WINNERS OF EDUCATION INVESTOR AWARD FOR CONSULTANTS TO THE PRIVATE SECTOR

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