Financial Results - Year Ended 31 March 2018

Investor Presentation

evolve
education group

Agenda

Overview of FY18 Performance

Overview of FY18 Performance

FY18 has been a challenging year for the business

- 4 successive years of flat Government funding continued to compress margins
- Occupancy fell by 2% at the start of FY18 due to lower new enrolments and child retention
- Evolve responded to lower occupancy by targeting occupancy growth in favour of reducing staff hours, with a view to preserving capacity
- A challenging acquisition market, and lessons learned from the integration of previous acquisitions, have meant a reduced focus on acquisitions in the near term

We are focused on operational improvement within the existing portfolio to recover earnings

- Improve occupancy over the coming one to two years
- Lift staff engagement and retention
- Return to previous levels of staffing/enrolments
- Address underperforming sites with remedial action

New centre developments have met expectations and will provide strong organic growth until acquisition prices for high quality centres return to acceptable levels

Evolve is undergoing a period of transition and consolidation

Initial Phase: FY15-FY17

New centre acquisition strategy

NZX/ASX listing

60 separate brands

Existing centre management teams brought into Evolve team

Transition Phase: FY18-FY19

Brand consolidation from 60 to 6 brands

Standardising systems to ensure a consistent customer experience

Growing regional and centre management capability

New centre development

Future Phase: FY20+

Driving Occupancy:

- Lifting teacher engagement
- Enhanced customer experience driving loyalty and reducing churn
- Improving our ECE centres – enhanced maintenance and quality programmes

Growth through mix of newly developed and acquired centres

FY18 Financial Results

FY18 Result Summary

NZ$000	FY 2018	FY 2017	% Change
Total Income	**158,953**	**151,623**	4.8%
EBITDA (underlying)[1]	21,631	27,591	-21.6%
Net Profit Before Tax and Non-Recurring Items	**16,655**	**22,362**	-25.5%
Less: Porse GST provision[2]	(3,000)	-	
Less: Impairment expense[3]	(13,890)	-	
Net Profit/Loss Before Tax	**(235)**	**22,362**	N/M
Less Tax	(3,978)	(6,489)	-38.7%
Net Profit/Loss After Tax	**(4,213)**	**15,873**	N/M
Net Profit After Tax and Before Non-Recurring Items[4]	**12,024**	**15,873**	-24.2%
Basic (and diluted) earnings per share (cps)	**(2.4)**	**8.9**	N/M
Fully imputed interim dividend (cps)	2.0	2.5	-20.0%

[1] EBITDA (underlying) is EBITDA before Porse GST provision, the after-tax impairment expense of $13.2 million relating to the Home-Based Division and the closure of one early childhood education centre, acquisition and integration costs. Refer to Appendix A for further detail. EBITDA is a non-GAAP measure and is not prepared in accordance with NZ IFRS. This measure is intended to supplement NZ GAAP measures presented in Evolve Group financial statements, should not be considered in isolation and is not a substitute for those measures

[2] Expense to settle the historic PORSE GST matter, a non-recurring expense

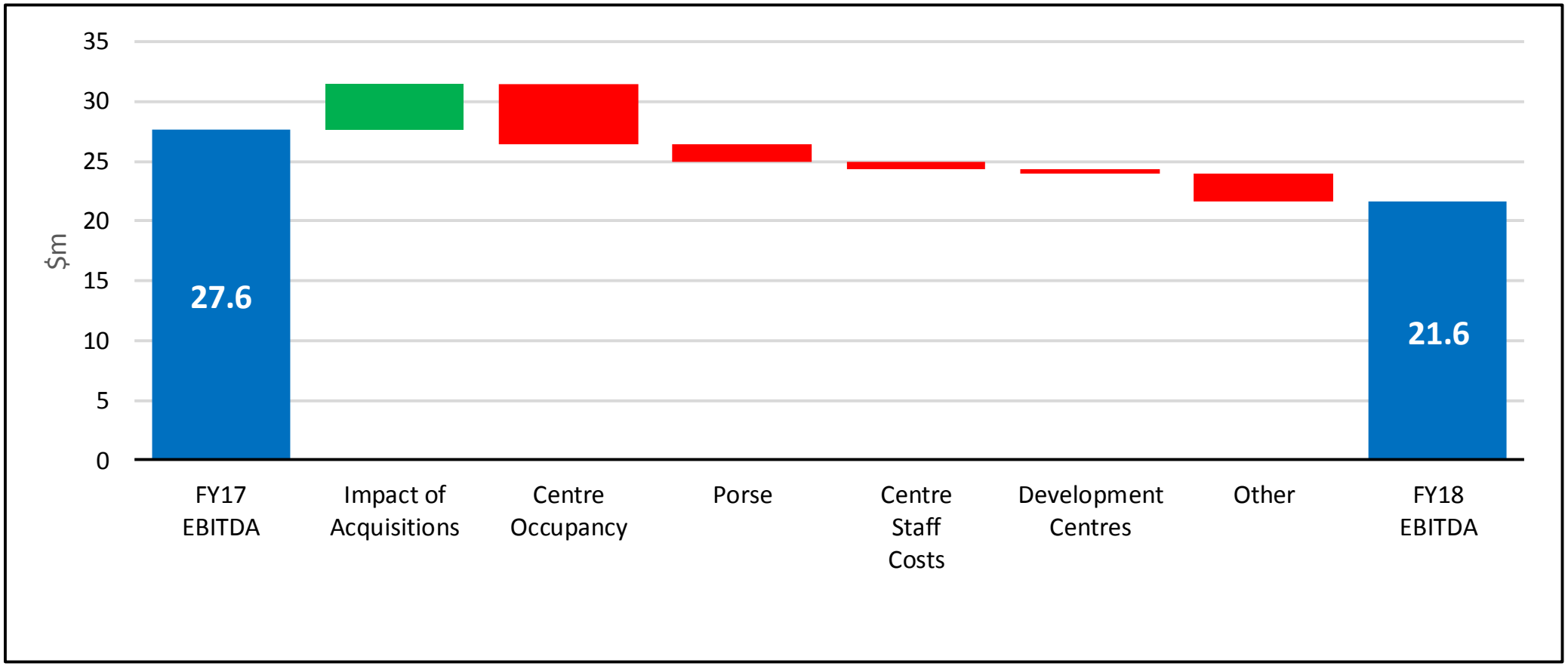
[3] Impairment expense of $13,890 less tax benefit of $653, in respect of Home-Based Division and one ECE Centre

[4] Refer to Appendix for reconciliation

FY18 Financial Result Commentary

- Net Profit After Tax before non-recurring items of $12.0m
- Net Loss after Tax $4.2m, after non-recurring items, being Porse GST settlement expense of $3.0m and non-cash impairment charge of $13.2m
- Total income increased by $7.3m (4.8%) of which $15.3m is due to the Centre acquisition programme, offset by a decline in enrolments in both Centres and Home-Based Divisions
- Occupancy in the Centres division was 2% lower, on average, on a comparable basis (i.e. same-centre occupancy)
- Enrolments in Home-Based were also lower than the prior year
- Three development centres impacted earnings due to start-up costs in the period: EBITDA losses of $499k were anticipated and in line with budget
- Final dividend of 2.0cps, as previously indicated to the market.

EBITDA movement: FY17 to FY18



Lower centre average occupancy rates were the main cause for the reduction in earnings in FY18

Segment Results

NZ$000	FY 2018	FY 2017	Change
Income			
Mature Centres	137,203	126,399	10,804
Development Centres	796	120	676
Total Centres	137,999	126,519	11,480
Home-based	20,558	24,060	(3,502)
Other income	396	1,044	(648)
Total income	**158,953**	**151,623**	7,330
EBITDA (underlying)			
Mature Centres	28,504	31,130	(2,626)
Development Centres[1]	(499)	(153)	(346)
Total Centres	28,005	30,977	(2,972)
Home-based	881	2,611	(1,730)
Corporate costs	(7,255)	(5,997)	(1,258)
EBITDA (underlying)[2]	**21,631**	**27,591**	(5,960)
EBITDA (underlying) margin %	**13.6%**	**18.2%**	

[1] During the period there were three (FY17: one) development centres operating in start-up phase.

[2] EBITDA (underlying) is EBITDA before Impairment Expense, Porse GST provision, acquisition and integration costs. Refer to Appendix A for further detail.

Centre Metrics

	Acquired by March 16		FY17 Acquisitions		FY18 Acquisitions
	FY18	FY17	FY18	FY17	FY18
Centres - period end	104	105	15	15	7
ECE licensed places – period end	7,142	7,163	1,162	1,162	625
Occupancy - average	80%	82%	69%	67%	75%
Employee expenses/revenue	53.8%	51.4%	58.5%	57.4%	58.5%
Underlying EBITDA Margin%	21.6%	25.2%	14.9%	15.6%	17.3%

- Data presented excludes 3 Development Centres – refer slide 28
- Occupancy on a same centre basis was 2% lower than the prior year for FY18
- Occupancy on the FY17 acquisitions has remained largely unchanged, after taking into account the phasing of acquisitions in FY17
- Occupancy on the FY18 acquisitions has remained largely unchanged since the date of acquisition, no material short term decline in the integration months
- Decline in occupancy did not lead to any overall change in staffing cost so lifting the employee expenses to revenue ratios, the primary reason for the decline in EBITDA margins.

Impairments

- Declining enrolments since the date of acquisition by the Group have reduced the revenue and profitability of the Home-Based Division.
- An impairment charge of $12.9m is reflected in the FY18 result to write off the non-current assets (primarily intangible assets) of the Division.
- The impairment is in accordance with financial reporting standards, and does not necessarily reflect the company's assessment of realisable value. It is anticipated that some part of the impaired asset value will be recovered through the sales process, though this amount cannot be reliably estimated at balance date.
- Further $1.0m of goodwill associated with the centres division was written off following the merger of 2 centres.

FY18 Impairment Charge	
Reduction in carrying value of Home-Based business	(12.9)
Goodwill write off following merger of 2 centres	(1.0)
	(13.9)
Less tax benefit	0.7
Net Impairment Charge after Tax	**(13.2)**

Balance Sheet / Funding

- Underlying gearing ratio (Net Debt: EBITDA) of 1.24 as at 31 March 2018
- Debt facility was renewed post year-end to provide a $70m acquisition facility and $25m working capital facility through to April 2022. Overall increase of $5m in funding lines.
- $60m of the acquisition facility has been utilised during the post-IPO acquisition programme, leaving $10m available, over and above retained cash
- Evolve is forecast to remain well within its banking covenants

FY 19 Priorities

Evolve’s strategic objectives remain unchanged

While FY18 has proved to be a challenging year for Evolve, our goals remain largely unchanged from those established at the time of listing:

- Be a leader in the strong demand Early Childhood Education sector in New Zealand
- Achieve the competitive benefits of a scale operator in a largely fragmented industry
- Continue to expand through measured acquisition of centres
- Undertake new purpose-built, purpose-located developments
- Maintain a level of profitability to provide a strong flow of funds for reinvestment in the business, whilst maintaining a 40%-60% dividend return to shareholders.

The sale process for the in-home childcare business (Porse) has commenced, following a strategic review which concluded the business was non-core and presented limited overlap with the ECE centres.

FY19 Priorities

We are focused on a two pronged strategy – stabilising the existing business through operational performance improvements and pursuing opportunities for portfolio growth and active centre portfolio management.

Operational performance

- Improve occupancy
- Improve engagement and retention of centre staff
- Re-balance teacher: child cost ratios
- Improve ECE centre support services e.g. Property Maintenance

Active growth initiatives

- Leasehold developments
- Active centre portfolio management

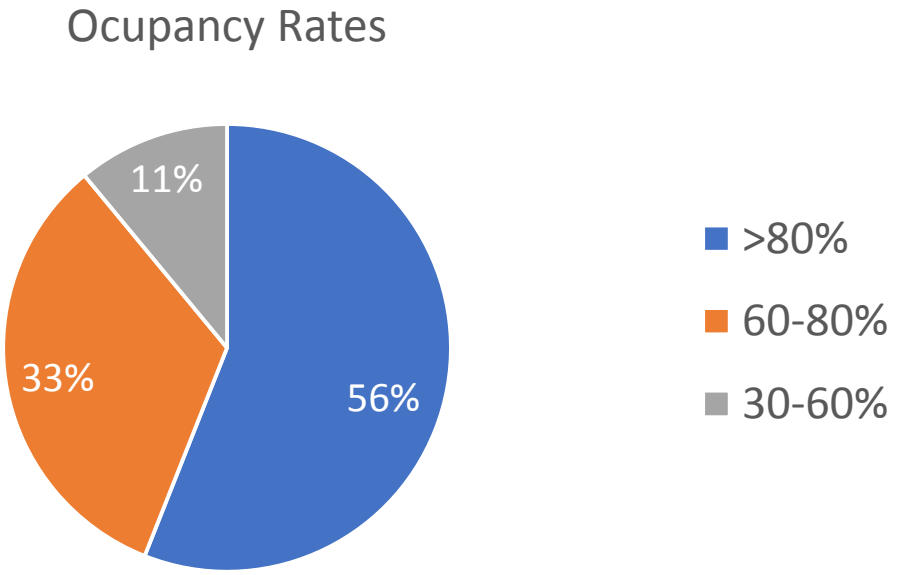
Occupancy

Occupancy Trends

Overall occupancy was 2% lower than FY17 on a like for like basis (i.e. the 104 centres owned throughout FY17 and FY18):

- 38% of centres gained occupancy – an average of +9%
- 62% of centres declined in occupancy – an average of -8%

The majority of centres continue to have strong occupancy. 56% of mature centres have occupancy above 80% (averaging 93%);



Driving occupancy

The key drivers of occupancy are:

- The engagement and retention of ECE centre staff
- A consistent and high quality service experience for parents and children
- Well-maintained and equipped ECE centres

Actions underway or proposed:

- We have established a central enrolments team to co-ordinate the enrolment process, and ensure that all leads are followed up
- We have ensured that we are price competitive in areas of high competition, particularly during the key enrolment period of January to March
- We have increased investment in a co-ordinated digital marketing strategy
- We will be surveying departing parents to identify service improvement opportunities

People and culture

People & Culture

The success of Evolve depends on engagement and retention of its teaching staff and centre management team

- Retention and engagement of teaching staff is the key driver of occupancy
- As a scale operator it is important that Evolve differentiates itself as an employer in the ECE sector
- There is significantly more that we can do in this regard

Over the coming year our initial actions to improve this aspect will include:

- Further developing a targeted Professional and Career Development programme for centre managers and teachers
- Using our scale to improve the working experience of our teachers and centre managers. As a first step we will establish a property maintenance management function to assume this responsibility on behalf of our centre staff in the first half of FY19
- Improving the quality and focus of internal communications
- Providing greater support from the corporate office around recruitment and staff deployment

Re-balance Costs

In FY18 wage/revenue % on a like for like basis increased from 51.4% to 53.8% as we held staffing levels despite the reduction in occupancy in anticipation of higher enrolments

To re-balance costs to industry benchmark levels, we will implement the following in FY19:

- Proactive management of staff costs on a centre by centre basis - by lifting the commercial focus of centre management
- Rostering system – evaluation and implementation of a system that is easy to use and configured to the requirements of a multi-centre New Zealand ECE group
- To improve management of our existing internal pool of relieving staff, we will use Staff Sync software to provide improved reliever options to centre managers. This should reduce the need to use expensive agency-provided staff

Addressing under-performing centres

Addressing under-performing centres

14 centres have occupancy rates of between 30% and 60%

11 centres generated an EBITDA loss in FY18, totalling $0.5m:

- 1 centre was merged with another subsequent to balance date, to address persistent low occupancy challenges of both sites
- The others have been reviewed, the causes of low occupancy pin-pointed, and remediation plans have been initiated
- It is anticipated that the remaining 10 loss making centres can be brought back to profitability during FY19

Acquisitions / Developments

Acquisitions

- Lack of quality opportunities at attractive prices has reduced our current focus on the acquisitions market
- Evolve's acquisition bank facility of $60m has been substantially drawn, with $10m added to the facility subsequent to year end providing headroom of $10m
- Vendor pricing expectations have shown some signs of reducing, though still inflated
- Over time the acquisition market is expected to re-set and allow further expansion through select acquisition
- We will continue to explore acquisitions that meet our criteria and reflect sensible valuation metrics.

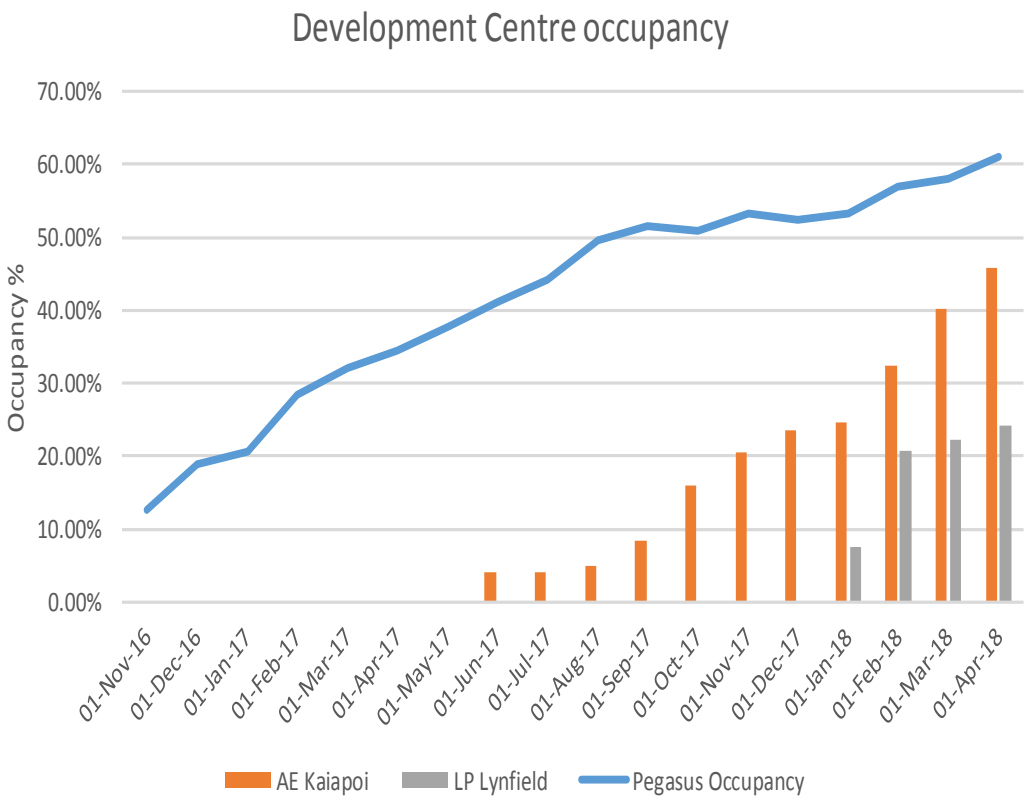
Developments

3 development centres have been successfully opened in the past 18 months

Average of 80 licensed places per centre, slightly above portfolio average of 70

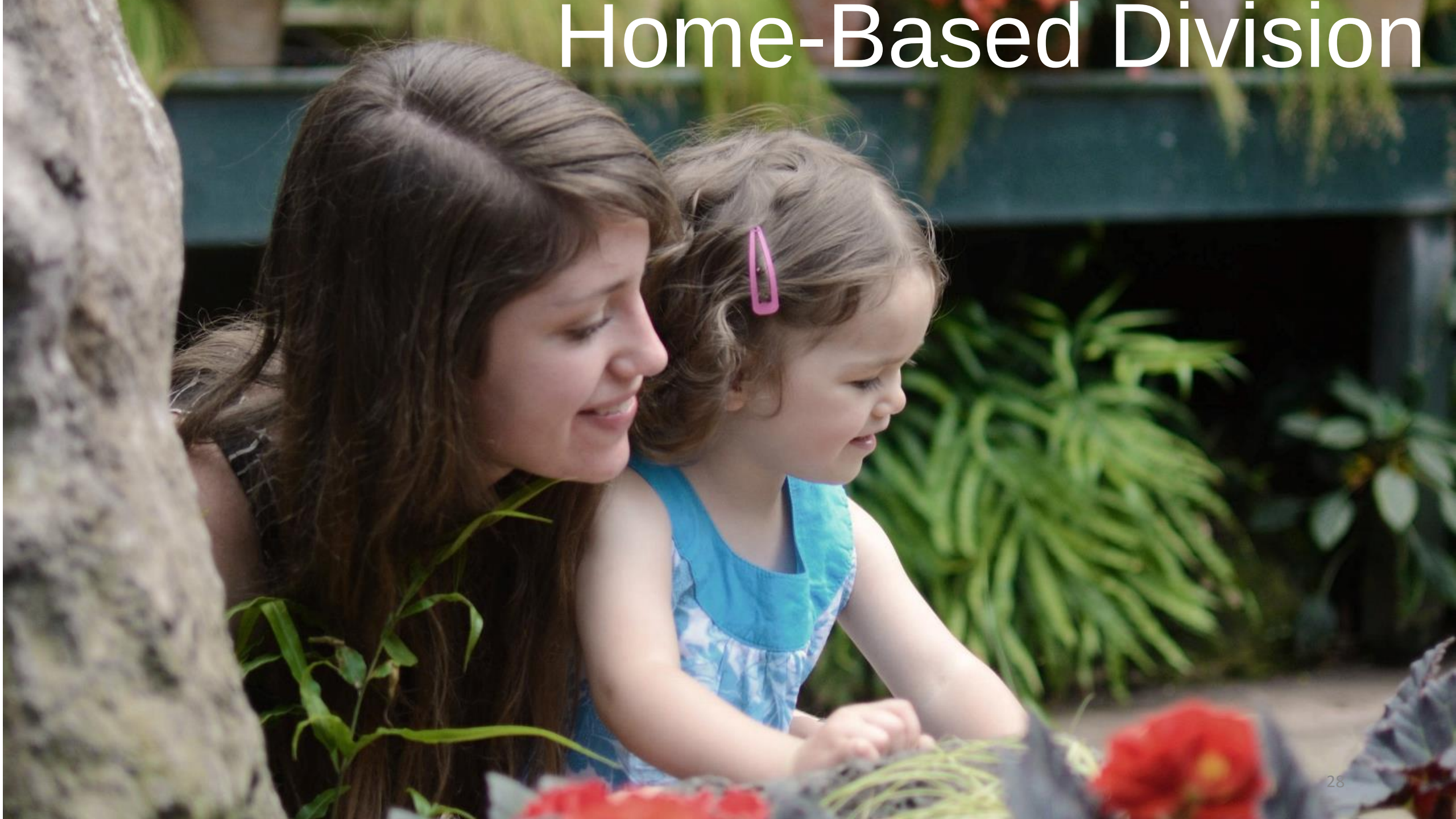
4 more signed up to open during FY19:

- Papakura
- Napier
- Mt Wellington
- Helensville



Two of the three trading centres have exceeded 50% occupancy and are anticipated to reach financial breakeven imminently. Cumulative trading loss of $649k vs projected mature annual EBITDA of $430k for the three trading centres.

Home-Based Division



Home-Based Division

- The market for home based ECE services continues to attract new participants. Both Porse and Au Pair Link continue to hold segment-leading positions, however, enrolments - which drive revenue - have declined 15% vs FY17

- It has not been possible to maintain EBITDA through cost saving in the face of a 15% decline in revenues and EBITDA has declined to $0.9m in FY18 from $2.6m last year

- As a result of this ongoing market trend the book value of the Home Based Division has been reducing, giving rise to an FY18 pre-tax impairment charge of $12.9m

- The impairment is in accordance with financial reporting standards, and does not necessarily reflect the company's assessment of realisable value.

- Evolve has decided to explore alternative ownership options for Porse. It is anticipated that some part of the impaired asset value will be recovered through the sales process, though this amount cannot be reliably estimated at balance date.

Government Support

Government support for ECE sector

- 1.6% increase announced for early childhood education centre universal funding in the 2018 Government Budget, beginning in January 2019
- The increase is welcome given that universal funding has been fixed for the past four years and the increase will help to alleviate some of the accumulated cost pressures
- The ECE sector has had to cope with rising costs which have not been offset by commensurate increases in funding from the Government
- The 2018 Budget did not address this historical issue
- It is clearly in New Zealand's best interests to have an early childcare education sector that is appropriately funded and able to attract and retain qualified and talented teachers. The new Government appears to recognise this requirement but has not been able, in its first Budget, to redress the funding backlog that has disadvantaged the sector over the last four years.
- The Budget announcement will not have a material impact on FY19 earnings because the 1.6% increase in funding has been held back until 1 January 2019, leaving only 3 months impact in FY19.

Outlook

Outlook

We are focused on delivering the following key milestones for FY19:

- Lifting overall occupancy to 79%, from 78%
- Opening 4 new development centres
- Reversing the recent trend of rises in the ratio of staff costs to revenue
- Improving employee engagement and retention
- Turning around the centres that are currently trading unprofitably

Government Budget announcement will not have a material impact on FY19 earnings, with increase in funding not commencing until 1 January 2019. We will be reviewing and implementing parental fee increases now the government funding for 18/19 year has been clarified

Earnings guidance for the year will be provided at the Annual Shareholders' Meeting

New CEO – refer separate announcement

- New CEO appointed: Rosanne Graham
- Mark Finlay will remain as CEO until 30 June, thereafter will act in an advisory capacity supporting strategic initiatives
- Rosanne Graham: strong strategic, people and operational leadership credentials, significant experience/leadership in the private education sector
- Rosanne to take the company to the next level, to implement the changes that have been identified as being required, and to work with the board to chart the strategic vision for the company
- Mark Finlay's valuable contribution to Evolve acknowledged by the board with appreciation

Appendix

Appendix A – Reconciliation of non-GAAP Financial Information

	Underlying (1) FY18 $000	Porse GST provision (2) $000	Impairment (3) $000	FY18 $000	FY17 $000
Total Income	158,953			158,953	151,623
Operating expenses	(137,322)	3,000	13,890	(154,212)	(124,032)
EBITDA before acquisition and integration expenses	21,631	3,000	13,890	4,741	27,591
Acquisition expenses	(102)			(102)	(714)
Integration expenses	(39)			(39)	(624)
Depreciation	(2,622)			(2,622)	(2,027)
Amortisation	(619)			(619)	(602)
EBIT	18,249	3,000	13,890	1,359	23,624
Funding costs	(1,594)			(1,594)	(1,262)
Profit before taxation	16,655	3,000	13,890	(235)	22,362
Taxation	(4,631)		(653)	(3,978)	(6,489)
Net Profit After Taxation	12,024	3,000	13,237	(4,213)	15,873

1 Underlying EBITDA excludes the Porse GST settlement expense, impairment expense, acquistion costs of $102k (FY17 $714k) and integration costs of $39k (FY17 $624k) for recently acquired centres, which are expensed for accounting purposes. These represent one-off up-front costs incurred to secure future income streams for the business.

2 $3m expense to settle the historic PORSE GST matter - a non-recurring expense

3 Impairment expense with respect to Home Based ECE division, and closure of one centre

Disclaimer

The information in this presentation is an overview and does not contain all information necessary to make an investment decision. It is intended to constitute a summary of certain information relating to the performance of Evolve Education Group Limited ("Evolve Education") for the year ended 31 March 2018. Please refer to the audited financial statements for the year ended 31 March 2018 that have been simultaneously released with this presentation.

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