Mayfield Childcare hopes investors will return to listed sector

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TIM BOREHAM
Criterion columnist
Melbourne

Eight years after Eddie Groves's foray into childcare became the ABC of how not to execute a debt-fuelled expansion, the quest to consolidate the sprawling $10 billion a year sector in a listed vehicle lives on.

But while the consolidation theme thrives again, there are lingering questions about whether some regions have reached saturation point and the earnings of for-profit operators are sustainable in a sector dominated by community operators.

The Victoria-based Mayfield Childcare on Wednesday joins the ASX boards, having raised $24 million to acquire 16 long day care centres (accounting for 1360 licensed places), in outer suburban Melbourne or regional centres including Bendigo and Kilmore.

An exception is Little Learners in leafy Camberwell, which is being acquired in a related party transaction for $5.3m from Mayfield directors Dean and Michelle Clarke.

Mayfield joins the much bigger **G8 Education (GEM, $3.22)** which has 478 centres here and a further 20 in Singapore. With an 8 per cent market share G8 competes for sector supremacy with the not-for-profit Goodstart Early Learning, which acquired most of ABC's centres.

Think Childcare (TNK, $2.27), which listed in October 2014, has 35 centres and 2761 - places.

The third-biggest provider Affinity Education last year was acquired by private equity interests, having warded off a hostile offer from G8.

As a pure play on the underlying property, **Folkestone Education Trust (FET, $2.39)** owns close to 400 properties here and in New Zealand.

“Although significant consolidation has occurred in the Australian childcare industry over recent years … the industry remains highly fragmented,’’ Mayfield says.

“Mayfield Childcare expects to achieve what it believes will be considerable advantages and benefits by amalgamating childcare centres under a central organisation and management structure.’’

Mayfield also intends to invest in systems to automate functions such as rostering and forecasting.

ABC Learning set out with a similar charter, with the central procurement of anything from crayons to nappies working a treat … for a while.

At one stage, ABC accounted for 20 per cent of the market before succumbing to Groves’s hubris marked by overexpansion and paying too much for centres in the first place. Synergy benefits can also go only so far, given labour costs — the highest components — are determined by strict child-to-carer ratios.

A feature of the sector is the predominance of government funding through the two mechanisms, the Child Care Benefit (paid to the operator) and the Child Care Rebate (of up to $7500 per child paid to the parents).

According to Mayfield’s prospectus, the industry has grown 12 per cent annually over the last five years. The estimated $10.6bn of turnover in 2015-16 year was 12 per cent up on the previous year.

Government subsidies account for $8.5bn, or 80 per cent of the turnover, and spur demand as parents have a higher incentive to return to work.

On government data, the average hourly fee stands at $8.50, compared with $8.05 two years ago. Assuming a 10-hour stay per day, that would be $425 a week.

The quid pro quo is that taxpayer largesse means tighter regulatory scrutiny, with the Australian Children’s Education and Care Quality Authority able to pull accreditation for centres that fail to pass regular audits.

These “arduous regulatory constraints” (Mayfield’s words) add to costs so are a pain in that regard. But they also create barriers for new entrants.

“The costs of compliance as a percentage of revenue tend to be significantly less for medium to large-scale childcare operators and Mayfield Childcare intends to take advantage of what otherwise would be a barrier to entry for small and individual childcare owners.’’

Mayfield’s business plan is also predicated on improving occupancy rates to an average 80 per cent, from 78 per cent. An additional two percentage points doesn’t seem like much, but it’s all cream on top when the bums-on-seats rate is high in the first place.

For some years now, the popular narrative around childcare has been the scarcity of places, which is often exaggerated because anxious parents put their spawn on more than one waiting list. A moot point is whether too many new centres are being built and whether they're in the right places. As a general rule, there are genuinely long waiting lists in many inner-city locations, but that tends not to be the case in the outer suburbs and regions where property is cheaper.

According to broker Cannacord Genuity, 56 new childcare centres were opened in the September quarter, taking the total number year to date to 180 compared with 167 previously.

Half of them were in NSW, although Sydney centres have fewer licensed places because of the cost and availability of land.

The 0.8 per cent increase took the total number of long-day centres to 6843.

The firm estimates 240 to 250 will be opened this financial year, but with about 50 closing. This net increase of around 200 centres "is equivalent to the number of centres required to keep up with the increase in demand''.

An encouraging sign is that 23 of the new centres (41 per cent) are in areas where the relevant population of zero to four-year olds exceeds the number of available places by more than three times. "This continues to suggest that in the majority of cases the appropriate needs analysis is being conducted.''

For the time being at least, the metrics are favourable.

Mayfield forecasts calendar 2017 earnings before interest, tax, depreciation and amortisation of $5.568m and net earnings of $3.53m, on revenue of $29m.

The company forecasts a healthy dividend yield of 7.65 per cent, based on a 65 per cent payout ratio. "In aggregate" the centres were profitable (in EBIT terms) in 2015-16.'' The most profitable is Little Learners, which boasts full occupancy.

G8 reported half-year EBITDA of $63m (up 11 per cent) and an underlying net profit of $32m (up 1.6 per cent), on revenue of $361m. This was despite a 10 per cent increase in wages.

Think Childcare turned over $24m in the half year to June, with EBITDA rising 37 per cent to $2.65m and net earnings jumping 45 per cent to $1.6m

Given its similar size and profitability to Mayfield, Think's $80m market valuation bodes well for the newcomer which will have an implied market cap of $30m.

But for those who want the sector exposure without dealing with the soiled nappies and snotty noses, Folkestone is a cleaner exposure.

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