evolve
education group

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Evolve issues trading update for the year ending 31 March 2018

- FY2018 Net profit after tax and before non-recurring items[1] now expected to be in the range of $11 million to $12 million, versus previous guidance of $14 million to $15 million
- Settlement reached with Inland Revenue Department on the historical Porse GST issue for $3 million

Evolve Education Group Limited (Evolve) advises that it now expects net profit after tax before non-recurring items for the year ending 31 March 2018 to be in the range of $11 million to $12 million, compared with previous guidance of $14 million to $15 million. Net profit after tax and after the Porse GST settlement amount is expected to be in the range of $8 million to $9 million. The earnings guidance includes approximately $0.5 million in start-up losses on new development centres that have commenced operations in the past year.

As outlined in the half year earnings announcement, achievement of full year earnings guidance was contingent upon meeting budgeted growth in net enrolments, particularly in the January to March period. While net enrolments were strong in the first three weeks of January, this was not sustained into February. Latest management figures show that total like-for-like Early Childcare Centre (ECE) net enrolments are 2% lower than at the same time in the prior year.

Total ECE enrolments are approximately 6% higher than for the same period last year, reflecting the new centres acquired and developed during the year. Porse In-home ECE enrolments are running at lower levels than last year.

The updated guidance also reflects rising cost pressures that have not been able to be fully countered by cost management initiatives.

Given the reduction in estimated full year net earnings, the final dividend for the year is expected to be 2.0 cents per share. This compares with 2.5 cents per share paid as a final dividend in respect of the 2017 financial year.

Evolve Chair Alistair Ryan said that the board is deeply frustrated that it has not been able to deliver the turnaround in performance that it believed could be achieved within the last six months.

"The board is confident that the Evolve management team can rebuild this business but what we have been disappointed to discover is that the recovery is no simple matter and is taking

[1] Net profit after tax and before non-recurring items is defined as net profit after tax and before the Porse GST settlement amount of $3 million, and any adjustments to asset carrying values.

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quite a lot longer than expected. Having said that, we believe we are on the right track. We will get our enrolments up and we will get the business structures right, but we are disappointed we have not been able to achieve this within our targeted timeframe. Good progress is being made by the management team in addressing the operational performance of the business but this is not yet showing up in net earnings. We have been hurt by an unexpected lack of momentum in enrolments which our brand and marketing strategies are aimed at correcting in the medium term. Having implemented significant changes at both board and senior management levels over the past six months, we are confident we have the right team in place to turn performance around.

"We are also having to confront the reality of more challenging industry dynamics, which is putting upward pressure on costs while revenues are relatively flat. We are also seeing growth in the number of competing new centres being brought into the market by property developers.

"While Ministry of Education payments for early childhood education have remained flat for the past five years, employee and facility costs have continued to rise. This is now being compounded by a shortage of qualified early childhood educators in some regions, which is putting further pressure on costs.

"We remain confident in the business model, but recognise that it will take some time to optimise the current mix of centres and lift operational performance. To support this, we will need to invest further in people and IT infrastructure which will weigh on short term earnings. The medium-term outlook for the company remains positive. We have a sound balance sheet and strong cash flows, and we believe that the actions we are taking will translate to improved earnings over time", Mr. Ryan said.

Commentary on Earnings Outlook

Evolve Chief Executive Officer Mark Finlay said that net enrolments in the period from December through to mid-February had not been sufficient to meet guidance.

"We had a strong start to the year with a surge in net enrolments in January, but this has tapered off in the past three weeks. Essentially we have tracked just below 2017 levels whereas we were targeting a significant gain in child numbers.

"We have a number of initiatives in train which we are confident will lift performance in the medium to long term. These include the appointment of a dedicated in-house recruitment specialist focused on hiring and retaining key staff, and the centralisation of the enrolment team. This team will handle all in-bound enquiries for our early childhood education centres, and offer a seamless, consistent level of service. So far, we have 50 centres being serviced by the team, and are looking to have 120 centres covered by the end of March".

Mr. Finlay said that in assessing the performance of the company, it was important to understand that there was a wide disparity in the performance of the company's ECEs around

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the country. Some centres are operating at full capacity with waiting lists, while others are not achieving the occupancy levels required to operate profitably.

"We are looking at region by region, centre by centre performance, and will be taking firm steps to improve overall performance though sensible rationalisation. At the same time, we still see good opportunities to invest in the development of new centres in selected geographies where the demand profile is strong. For Evolve to remain competitive we must continue to develop and upgrade our own centres in the right locations.

Mr. Finlay said good progress had been made with the brand rationalisation strategy, with the new brand signage now rolled out across most centres.

Settlement of Porse GST Issue

Evolve also confirms that it has finalised agreement with the Inland Revenue Department (IRD) in respect of various historical taxation matters relating to Evolve's wholly-owned Porse in-home childcare business (Porse).

The settlement agreement with the IRD will see Evolve pay $3.0 million to the IRD and will ensure all current areas of discussion between the IRD and Evolve and its subsidiaries are closed off.

Evolve has previously reported this matter as a contingent liability, then recorded a $3.0 million provision on its balance sheet in its interim report for the six months ended 30 September 2017. Payment of the settlement amount will be funded by Evolve's existing cash reserves.

As previously advised, the issue that has been under discussion with the IRD relates to the GST status of certain payments made in relation to home-based care delivery. The IRD has reviewed Porse's treatment for GST purposes of payments made to Porse home-based educators who are acting as independent contractors engaged by parents under the Porse system, and payments made to nannies who are acting as employees of the parents.

Porse has made changes to its operational infrastructure that it believes will help ensure that this issue will not arise again in the future. These changes are of such a nature that there will be no impact on the underlying operations of Porse.

Review of Asset Carrying Values

Evolve currently has $212 million of intangible assets on the balance sheet, mainly comprising of goodwill arising from ECE centre acquisitions and the Porse home-based care business. These assets are tested for impairment twice a year. At this time it is too early to conclude on the outcome of the impairment testing, as 6 weeks of the key enrolment growth period remains. However, with enrolments for home-based childcare currently tracking below the same period

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last year, and in the absence of any signs of improvement, it is likely that an impairment may be required.

Home-based intangible assets total $12 million. Any impairment will have only a marginal impact on the overall financial strength of the company, and Evolve will continue to remain well within its banking covenants with substantial undrawn credit lines available to it.

ENDS

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