CHRISTIE & CO

CHILDCARE & EDUCATION: 2022 MID-YEAR REVIEW

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INTRODUCTION

At the start of 2022, as detailed in our latest Business Outlook publication, we made a number of predictions, one of which was 'activity will remain buoyant'. Six months on, we can attest to this being wholly apparent, especially for the UK children's day nursery and specialist childcare markets.

During the first six months of the year, we saw unprecedented levels of market activity, including a 51% surge in owners deciding to sell their businesses, a proportion of whom chose to sell to take advantage of the stellar prices that the best businesses have continued to achieve. The emotional drain of having traded through a global pandemic, amid turbulence, challenges and uncertainty, has also resulted in a desire to sell. For some, their decisions have been influenced by inflation rates, economic uncertainty, and nervousness associated to the potential impact for earnings erosion due to increased operational costs, alongside nervousness of potential diminutions in value and a wider perception of potential risk associated with the uncertainty and post pandemic financial fall-out.

Despite the increasing cost of living, fuel prices at an all-time high, and ongoing workforce recruitment and retention challenges, owners of businesses demonstrating recovered revenue and earnings have plenty of reasons to be confident, as, so far this year, the best businesses have continued to achieve heady prices.

All corners of the UK have seen notable degrees of market activity. Deals successfully completed during the first half of 2022 include the sale of Pilrig Nursery in Edinburgh; a portfolio of children's homes in Liverpool; Armley Grange, an SEMH school in Leeds; Kloisters Kindergarten in Kent and DayDream Nursery in Woking.

Buoyancy across the childcare and education markets continues to be mirrored overseas, with active buyers across Europe and further afield seeking acquisition opportunities. One of the most notable global transactions so far this year has been the announcement of the sale of Australian ECEC provider, Only About Children (OAC), which is to be sold by Bain Capital Private Equity to Bright Horizons Family Solutions for $450 million (£256 million). OAC operates 75 ECEC centres in New South Wales, Victoria, and Queensland. Bain Capital initially invested in OAC in 2016, with its most notable pre-pandemic deal being the acquisition of a portfolio of 20 Little Learning School centres.

For 2021, the business reported revenues in the order of $140 million (£80 million). On completion of the transaction, which has been structured to include an element of deferred consideration, Bright Horizons will operate almost 1,100 ECEC centres across the UK, the USA, the Netherlands, India, and Australia.

Despite the increasing number of headwinds, the outlook for the remainder of the year looks positive. Throughout the most challenging of times, childcare and education businesses and the associated markets, have long proven to be resilient and, while there may be storm clouds ahead, we expect the markets to remain buoyant and for consolidation to continue.

99.5%

OF ASKING PRICE ACHIEVED, AN INCREASE ON THE PREVIOUS YEAR

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KEY STATS

47% INCREASE IN NUMBER OF INSPECTIONS FROM 2021 TO 2022 YTD

47%

51% INCREASE IN NEW INSTRUCTIONS FROM 2021 TO 2022 YTD

51%

50% INCREASE IN CHILDCARE BUSINESSES SOLD IN 2022 COMPARED WITH 2021 YTD

50%

34% INCREASE IN VIEWINGS FROM 2021 TO 2022 YTD

34%

DAY NURSERIES

As the pandemic has brought about heightened appreciation for early years education, we are seeing appetite from existing operators keen to grow their portfolios in this key, frontline sector.

Alongside continued demand from national and regional groups keen to acquire, there has been an increase in operators of smaller nursery groups (typically with one to four settings) whose businesses have fully recovered to pre-pandemic levels of trade, that are keen to expand.

As expected, we are seeing a highly competitive market, with first-time buyers competing head on with experienced buyers for high-quality settings with recovered occupancy, stabilised earnings, and established staff teams.

There is a continued eagerness from real estate investors wishing to enter the sector, alongside an increasing number of investors keen to partner with high-calibre management teams to facilitate new businesses to be grown via buy and build strategies. This strategy continues to be fuelled by the dynamics of the sector and the consolidation opportunities available. The greatest challenge for these investors remains the identification and creation of new management and leadership teams which from an investment perspective is key, particularly as this is a highly regulated sector which continues to navigate a host of operational challenges.

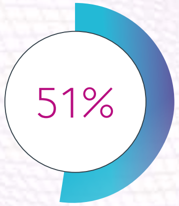
In keeping with our predictions, already this year we have seen multiple portfolios and high-quality single settings transact in very competitive sale processes.

Activity has remained incredibly buoyant, with buyers seeking to consolidate businesses that can show trade has returned to pre-pandemic levels.

During the first half of this year, we saw a little slow-down in demand from buyers for brownfield nursery development sites as well as lower levels of interest in properties with vacant possession and those in need of extensive refurbishment. This is largely due to strong upward pressures associated with the cost of construction materials, teamed with material and trade labour shortages, along with supply and logistic problems. Data from the Building Cost Information Service (BCIS) as published by the Royal Institution of Chartered Surveyors (RICS) in February 2022 predicted that construction tender prices are expected to slow over the second half of the year. Prime development opportunities will remain sought after by buyers, but tertiary locations are likely to see more sedentary levels of interest from buyers, with the cost of capital and timescales for ROIs increasingly being at the forefront of buyers' minds.

Difficulties relating to workforce recruitment and retention are also factors shaping buyers' risk factor appraisals.

51% INCREASE IN NEW INSTRUCTIONS FROM 2021 TO 2022 YTD



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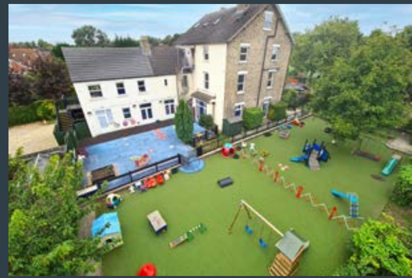
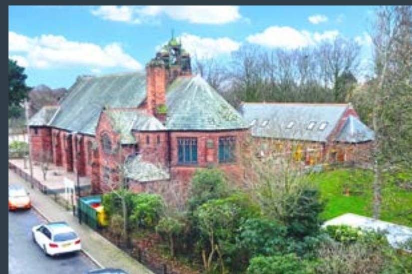
CASE STUDIES FROM H1 2022



THE HAVEN 2000 NURSERY AND PRESCHOOL, BEDFORD

The Haven 2000 Nursery and Preschool in Bedford is a well-regarded, award-winning setting which caters for up to 57 children aged zero to four years, and boasts such accolades as the Shine a Light Award, the My Smile (Oral Health and Education) Award, and the Communication Friendly Award. Following a confidential sales process, the setting sold to expanding operator, Play 2 Learn Day Nursery group.



THE CHESHIRE DAY NURSERY, NW ENGLAND

The Cheshire Day Nursery group - which comprises four nurseries and one kindergarten - occupies freehold and leasehold properties around the North West of England. Founded in 2000 by sisters Julie Mannering and Brenda Burling, the portfolio has a combined operating capacity for up to 464 children and a growing annual fee income of over £3 million. Following a confidential sales process, the group sold to Bright Stars.

SPECIALIST EDUCATION

AND LOOKED AFTER CHILDREN

As predicted, the specialist childcare market, so far this year, has been incredibly buoyant, with a wide range of well-funded buyers seeking schools and children's homes on both an operational and a vacant possession basis.

Alongside continued demand for specialist education and children's services businesses that are property asset-backed, there continues to be strong demand from buyers for foster-care businesses.

One of the most notable transactions so far this year is the merger between Accomplish Group and Keys Childcare. The combined organisation comprises over 6,000 staff, providing specialist support and education services to over 2,000 children, young people, adults, and families. The merger will see the organisation operate across three divisions: adult residential, independent living and activity services, and children's residential and education.

Increasingly during 2022, research has further emerged evidencing that some children and young people's mental health and wellbeing has been substantially impacted during the pandemic. Between March and June 2020, a period when schools were closed for most pupils, symptoms of depression and post-traumatic stress disorder (PTSD) were found to have significantly increased in children and young people aged between seven and a half and 12 years old, compared with just before the pandemic.

Over the course of the last 18 months or so, as we have transitioned out of the initial UK lockdowns, and as children and young people returned to school, the impact of these lockdowns on our most vulnerable children and young people has become increasingly evident. During 2021 we saw a surge in demand from operators desperate to find properties suitable for use to support the increase in the number of referrals from local authorities, as well as a notable uptick in demand from providers for suitable properties capable of conversion into specialist residential and educational use. This surge has continued into 2022.

Demand from buyers for existing operational businesses remains unprecedented, however, few business owners are open to sell at the moment, despite the heady prices on offer. This is mainly because local authorities and commissioners continue to desperately seek suitable services for children and young people in need, so many business owners are, instead, focused on striving to increase capacity to service this surge in demand.

During recent months, we have seen an increase in the number of rurally located children's homes with smaller capacities being brought to the market with vacant possession. These opportunities are, in part, available due to difficulties of recruiting qualified staff - a problem which is heightened in rural areas - and are drawing interest from a wide pool of buyers interested in both prevailing use for individuals with high acuity care needs, and buyers seeking to acquire for private residential use.

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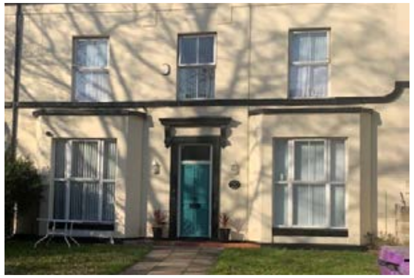
CASE STUDIES FROM H1 2022



CONSIDERATE CARE LTD, LIVERPOOL

Considerate Care Ltd comprises two homes in Liverpool which are registered to support up to four young people aged 11 to 17 years, and eight to 17 years who display social, emotional and/or behavioural difficulties (EBD) or who may have learning difficulties. Following a confidential sales process, the business was sold to Keys Group, one of the UK's largest independent providers of residential care and specialist education.

ARMLEY GRANGE SCHOOL, LEEDS

Armley Grange School in Leeds is a unique site recently renovated to a high standard for SEMH provisions. It comprises an early nineteenth century mansion house and a separate, recently renovated annex extension set within approximately 1.23 acres of secure mature grounds. Following a confidential sales process, the site was sold in May 2022 to a nationwide specialist childcare group.

INDEPENDENT EDUCATION

The first six months of 2022 have proven that appetite from those seeking to acquire and invest in independent schools has not been dampened by the pandemic.

Appetite continues to come from a wide pool of buyers, many of whom have educational backgrounds. There is a particular increase in interest from buyers for smaller provincial schools - a shift in trend compared with pre-pandemic times - as well as a renewed interest from overseas school operators, perhaps seeking to ensure that they have a UK presence to future-proof challenges around student migration, should this issue resurface.

While buyer demand for operational schools remains intact, the volume of transactions has been slightly supressed so far this year, which is principally due to financial performances being largely distorted for the financial years ending August 2020 and August 2021, with buyers for schools being more cautious in comparison to buyer behaviour across other market sectors. Year to date, we have seen a broadening gap between schools that have been revived and have thrived as a result, and those in increasingly untenable financial positions.

One of the most notable deals so far this year has been Patron Capital Partners' acquisition of Wishford Schools; a group of eight prep schools and a co-educational day and boarding schools, educating more than 2,500 pupils across Berkshire, Gloucestershire, Kent, and Wiltshire.

At the beginning of the year, we predicted that a number of business casualties would come to the market in 2022, including some provincial schools, colleges and tuition centres which have failed to regain student numbers - especially those with a high dependency on international students - and would likely face the greatest financial sustainability challenges. This has become more apparent as this year has progressed.

During recent months we have seen an increase in smaller provincial schools that have continued to face acute financial challenges - some of these were insolvent pre-pandemic and that position has subsequently worsened.

For schools making the difficult, and often incredibly emotional, decision to close, a small degree of comfort can be taken from knowing that school buildings remain in demand from buyers that seek to create and deliver specialist education services.

Arising, in part, from the impact of the pandemic, and due to the increase in the number of children and young people identified as needing additional educational support, we predict that demand for former schools, if brought to the market with vacant possession, will continue to receive a high level of interest from a wide buyer pool.

CASE STUDIES FROM H1 2022

ST PETER'S INDEPENDENT SCHOOL, NORTHAMPTON

We worked on the sale of St Peter's Independent School in Lingswood Park, Northampton, which formerly operated as a charitable trust offering independent education to around 140 pupils aged 3 to 16 years. During the marketing process, interest was received from variety of prospective purchasers, and the site was subsequently sold to a leading independent operator of special needs schools, transition homes, supported care and community support services for young people.

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BUSINESS OUTLOOK 2022 MARKET PREDICTIONS

DAY NURSERIES

Activity will remain buoyant

Regional operators will continue to consolidate, acquiring single settings and small groups

Several high-profile portfolios will change hands between trade buyers and new investors

A two-tier market will emerge

Outstanding CAPEX requirements will impact prices achieved for tired assets

Regulatory pressures arising from inspections, if not deemed to be fair, could result in owners permanently closing sites

Real estate developers will increasingly seek land suitable for organic nursery developments

Property investment appetite will continue to grow. Yields are predicted to sharpen as tenant diversification prospects widen and covenant strengths improve.

SPECIALIST EDUCATION

Demand for residential children's businesses, especially those that provide a range of therapeutic services, will surge at the end of Q1 and Q2 2022 following the passing of the statutory deadline for the publication of the CMA report

We expect to see several significant transactions in 2022

Pent-up demand from buyers will fuel competitive tension, resulting in premium prices for those selling during 2022

Independent Fostering Agencies (IFA), especially those with 200+ carer partnership, will continue to be greatly sought after

Cash buyers will continue to hold the upper hand

Unregulated services will be in the spotlight

BUSINESS OUTLOOK 2022 MARKET PREDICTIONS

INDEPENDENT EDUCATION

Provincial schools, colleges and tuition centres that have failed to regain student numbers will face the greatest financial sustainability challenges and so we expect a number of casualties in 2022

Vendors' willingness to accept more realistic prices should keep the transactional market moving across the regions

Independent mainstream school's capacity for 1,250+ pupils and SEN schools will remain sought-after by domestic and international buyers

Schools with a high dependency on international students will continue to face challenges

Closed and vacant former educational establishments will continue to secure strong interest from specialist education providers and developers


ADDITION EXERCISE