TRANSCRIPTION

Company:	**G8 Education Limited**
Date:	**9 December 2020**
Time:	**9:00am (AEST)**
Duration:	**36m 53s**
Reservation Number:	**10011291**

[START OF TRANSCRIPT]

Operator: Thank you for standing by and welcome to the G8 Education Ltd. Conference Call. All participants are on listen only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question, you will need to press the star key, followed by the number one on your telephone keypad. I'd now like to hand the conference over to Mr. Gary Carroll, CEO. Please go ahead.

Gary Carroll: Thank you and good morning everyone. And thanks for joining the trading update call for G8 Education. My name's Gary Carroll and I'm the CEO and managing director of G8 Education Ltd. I'm joined on the call today by the group CFO, Sharyn Williams. We'll walk through the investor presentation that was posted on the ASX earlier this morning, and then we'll provide time for any questions. Slide four of the presentation pack sets out the summary of the achievements for the year to date. Both from an operational and a strategic perspective, as well as providing a high level outlook for 2021.

Starting with operations, it's been pleasing to see occupancy continue the recovery that was highlighted in our half-year results presentation in August. With like-for-like occupancy currently at 75 and a half percent. The group has continued to manage costs well, which, when combined with continued government support, has allowed us to increase investment in key areas, such as in-centre resources and repairs and maintenance in the fourth quarter.

Our unaltered, underlying EBIT, as of the end of November, was $98 million, including current year wage costs relating to the employee payment remediation programme. From a strategic perspective, the groups made good progress in its portfolio optimization activities with the divestment programme for our 52 impaired centres being on track and the sale of the Singapore business being completed. Our re-engineered improvement programme, in which all activities except for major asset refurbishments were continued despite the challenging COVID-19-related environment, has progressed in line with expectations, with approximately 100 centres being covered by the programme in 2020.

s flagged in August, G8 undertook a comprehensive proactive review of its award and legislative requirements as part of the implementation of its new rostering system. This review identified inadvertent award non-compliance and a remediation programme has commenced, with total one-off pre-tax costs estimated to be between 50 to $80 million. And I'll talk more about this remediation programme shortly.

Looking ahead to 2021, the group will continue to focus on three main areas. Firstly, the optimization of our portfolio, involving the divestment of our previously impaired centres, secondly, the continuation of our improvement programme and lastly, the measured rollout of new Greenfield centres, using our revised investment model. While we do expect general economic conditions to be impacted by COVID-related events in 2021, the progress to date and our key focus areas gives us the confidence to increase the pace in these areas, particularly the improvement programme. The cost of the programme will be managed to ensure they are funded by the benefits of the overall strategic programme.

Slide six unpacks the trading results in more detail. The year to date underlying EBIT result has been driven by two factors. Firstly, good operational delivery, as well as the benefits of government support. I'll talk more about occupancy and wages in more detail shortly.

I wanted to highlight two impacts in relation to the 2020 profit results. Firstly, the group did not implement a fee increase in 2020, as stipulated by the government subsidy arrangements. We have also chosen to increase our cost investment in quarter four by around eight and a half million dollars, covering RNM and in-centre resources. These investments are designed to continue G8's improvement in quality, which will have positive benefits in future years. Capital expenditure for 2020 is expected to be around $31 million, in line with previous guidance, while the group's net debt has been reduced, such that we are in a broadly cash neutral position. We continue to enjoy strong support from our lenders with amendments, the bank cabinets in place until December 21 and the refinance process being on track to be completed in early 2021.

Slide seven shows the group's 2020 occupancy performance in detail. It's pleasing to see the group narrowing the occupancy gap by around five and a half percentage points since the April low, with the current gap for the last year at approximately four and a half percent. The growth has been reasonably even across the states, with the exception of Victoria, which took longer to ramp up due to longer lockdown periods and the ACT, where the group has experienced higher than normal turnover on centre managers. The impact of the lockdowns in Victoria is evident on slide eight, which shows the attendance trends for the year. Importantly, all states are now demonstrating a normal differential between occupancy, as represented by bookings, and attendances. Slide nine outlines the group's performance in relation to wage hours per booking in 2020. On an overall basis, G8 delivered wage efficiencies in line with its targets for the year. A straight year-on-year comparison is very challenging, due to the very different occupancy levels in 2019 and 2020.

To highlight the improvement in wage efficiency in 2020, we have marked the wage hour per booking result at the same occupancy level, in this case, 74%. The improvement in wage efficiency in 2020 at the same occupancy level is clear. With this result being achieved as a result of utilising the technology platform that forms part of G8's new rostering system. Important to note these relative efficiency improvements are not impacted by the employee payment remediation programme. The other key point in this slide is that wage efficiency is absolutely impacted by occupancy. This is clearly reflected in November, 2020, where the drop in wage efficiency was driven by the five percentage point difference in occupancy.

I'll now provide further details on the remediation programme that is underway to address award and legislative compliance issues. Let me first start by saying that our team members are critically important to providing the best learning foundations for our children and support for our families and the commitment of our people, particularly during the challenges we've faced this year is our key to success. As mentioned at the start of the presentation and outlined in slide ten, a proactive review of award and legislative requirements was undertaken as part of our new rostering system implementation. That review identified inadvertent non-compliance issues covering the past six and a half-year period. These issues primarily relate to payment for overtime, minimum engagement periods, and agreed hours of work and allowances. In many cases, the issues arose due to insufficient documentation of agreed hours. G8 is voluntarily self-reported-to and is engaging with the fair work ombudsman in relation to these issues. Total one-off remediation costs of these issues is presently estimated to be 50 to $80 million on a pre-tax basis. This includes estimated direct wage costs of approximately 38 to $60 million. Wage on costs, interest, and remediation programme costs.

Worth noting that the direct wage cost impact represents between one and a half and two percent of the total wage cost over that six and a half-year period. And for those wanting to understand the impact of the programme on CY20 EBIT, the year-to-date results include the provision of approximately $12 million in relation to this programme. Now these estimates are based on preliminary analysis and assumptions, and these costs, net of tax, will be funded from existing cash reserves.

Our remediation programme is underway and the group is committed to ensuring that all team members are paid correctly moving forward. The remediation programme is expected to be completed by 31 July, 2021. A new rostering system, which is designed to automate certain award compliance and improve visibility, is scheduled to be fully implemented across G8's network by the end of half one, CY21. In the interim, the group will be utilising the centralised processes designed as part of the new HRS system to mitigate the impact of these issues. Accordingly, G8 does not expect any material impact wage costs in future years as a result of these issues. Really the group deeply regrets these pay issues have occurred and we apologise unreservedly to all affected team members.

Turning to slide 12, which sets out the group's near term strategic priorities. Firstly, roll out of the new rostering system is on track with the end-to-end process being deployed for the first pilot group of centres with a larger pilot currently underway. Full rollout across the remaining network will commence in early '21. Secondly, it's pleasing to see that 2019 pilot centres, and our improvement programme, performing in line with expectations in terms of occupancy and other key metrics.

Around a hundred centres will be completed in 2020 as part of the programme with planning being finalised for the 2021 cohort. From a network optimization perspective, active negotiations are underway to exit 27 previously impaired centres in line with schedule. We outlined our revised approach to Greenfield acquisitions in the half year update in August which significantly reduced capital outlays per centre, driving higher returns on capital. The group is progressing a number of negotiations using this new model with good acceptance from developers. Turning to our outlook on page 13, the group expects 2021 to be a recovery year, as Covid-19 continues to impact particularly on occupancy, either directly through movement restrictions or indirectly through economic impact, such as higher unemployment. Lower occupancy levels in a regulated wage environment, impact wage efficiency. This compounded by the absence of a CY23 increase, increases wages as of percentage of revenue. Neat service strategic priorities, and CY21 remain on executing the divestment of previously impaired centres.

The improvement programme and network growth. The improvement programme is expected to gain momentum in CY21 based on positive results to date and the medium-term earnings potential of this programme. The cost of the increased activity will be managed to ensure they are funded by benefit of the strategic programmes. Approximately 10 new Greenfield centres are expected in CY21 for a capital outlay of circa $4 million. Start-up trading losses in CY21 are expected to be around $4 million based on current standard opening dates with strong returns over the medium term as the centres mature. Catex differed from CY20 of $10 million will be released in 2021, taking the title to at least $50 million with further incremental spend based on return hurdles. That concludes the formal part of the presentation. I'll now open the floor to any questions.

Operator:	Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you're on a speakerphone, please pick up the handset to ask your question. Your first question comes from Tim Plumb with UBS. Please go ahead.
Tim Plumb:	Hi Gary, a couple of questions from me, but I might just ask two and then I'll jump back in the queue again. Just in relation to the wage costs, you know, obviously it's depending on occupancy. But how should we be thinking about labour costs as a percentage of revenue going forward next year, in broad terms?
Gary Carroll:	Yeah, so there's two factors to take into account Tim. One is no fee increase in 2020, but there were wage increases. So if you model two years of wage increases, but only one year of fee increase, you'll see some margin compression off the back of that. And I think the percentages are quite straightforward for you. The second is the impact on wage efficiency, which we tried to provide some guidance on slide nine that will have an impact, clearly won't be quantifying it but we're hopeful that people will take both factors into account when they're coming up with an estimate of wages. But wages will go up as a percentage of revenue.
Tim Plumb:	Yep. And then just in terms of those Greenfield's, so it looks like 400 grand loss in year one. How should we think about the earnings profile or the expected earnings profile of those new centres over the next couple of years?
Gary Carroll:	The broad operating metrics of those centres are no different to the balance of our portfolio in that a place centre, depending on the fees should be generating a bit north of $300,000 per centre on an ongoing basis.
Tim Plumb:	Got it.
Gary Carroll:	Yeah. So that gives you a good sense of their return potential of that kind of portfolio.
Tim Plumb:	And over what period would you expect to see that?
Gary Carroll:	So our ramp up period has varied across that portfolio. What we have done is model the impact of the center's locations, and other characteristics that we're currently negotiating it. We benchmarked it against similar centres, that form part of our previous Greenfield pipeline. And there you'd say the ramp up period is between 12 and 18 months, to get to that maturity.
Tim Plumb:	Right. Okay. Thanks guys. I'll jump back in the queue.
Operator:	Thank you. The next question comes from John Hinde with Wilson's. Please go ahead.
John Hinde:	Good morning, Gary and Sharyn, thanks for taking my question. Just want to ask a few questions around the Greenfield. All 10, just confirming you're expecting all 10 centres to open in 2021. How should we think about this

profile going forward? And it looks like this is back on the agenda for you. And I guess what gives you the confidence this time around about the center's and the earnings profile and the risks to supply given what investors with dealing with in the last sort of three to four years with the previous portfolio?

Gary Carroll: Yeah. So, two key changes for me, John. One, we have changed a number of key members of our team and in our property development space. And I'm certainly very excited about the capabilities that added new people have brought to that team. The increased rigour around assessment of future supply demand and ensuring that we're actually in locations that we're extremely pleased with, versus a portfolio that was more on inherited basis previously.

And the second element is we're more proactive in our design of the centre itself. So we're able to incorporate the elements that we want to see as opposed to inheriting a design from developers. That also enables us to have much greater control over the timing of opening, as opposed to our previous arrangement. So you'd really say, it's been pretty much completely re-engineered in terms of site selection, site design, construction management, and economic modelling of supply demand. And we're very strict on ensuring that we're going into areas where we feel that there's an attractive supply demand balance. And as you would have noted in August when we did our impairment review, that wasn't evident in our previous Greenfield portfolio in all centres.

John Hinde: Yeah. Thank you. So just following on from there, the centres, will you be dealing with an incubator partner or is this is all on balance sheet and I guess how are the occupancy or inquiry levels looking as you start bringing these guys both those centres out of the ground?

Gary Carroll: Yeah. So a couple of points to note, one, it's not an incubator in the sense that maybe others in the market have where they pick it up at a certain occupancy level. We will be inheriting these centres that open and building the occupancy from scratch. The capital outlay then reflects that John. So, we're essentially paying for the fit-out of the in centre resources, maybe a small contribution to other fit-out. So you're talking about a $400,000 capital outlay versus a $3 million in an incubator type arrangement to take account of that. We need to build ramp up occupancy. The actual inquiries process hasn't really occurred to the number of these centres, the majority will be opening in the second half of the year in 2021. And that's a function of when we've started rolling out the new model and the construction profile that comes with that.

John Hinde: That's great. Just, one more for me before I jump in the queue, the asset sales, I think there was 52 originally flagged when you they were losing about $14 million at EBIT. When can we get, I guess, detail on completion sale for this? I think it's 25 centres or 27 centres. And how far away are the rest? And also how are you selling centres in the current environment, are there any additional hurdles you need to jump over?

Gary Carroll: Yeah. So what we intend to do, John is keep the market updated as we progress

Through and complete negotiations is the reality is that they're not five minute negotiations, so trying to come up with a forecast in terms of timeline's pretty difficult for us. Certainly been happy with the progress made, but it's very difficult, as I'm sure you can appreciate, to predict and kind of slotting that quarter by quarter this is what we're going to expect.

We're pursuing a number of options in terms of how we exit those centres. For the nearer term leasing expiries, it may be a matter of getting to a lease surrender amount that's amenable to both parties and we exit the centre that way. For other centres where it's more long term lease, it's a sales process. We have engaged a couple of partners to assist with the sale process for those longer term leases. That process has just commenced, so it's quite difficult at this point to come up with any timing.

The focus over the last three months has been on the exits from a surrender point of view and we've made some pretty good ground. I expect us to provide a more fulsome update in February as we progress through.

John Hinde: Thanks. Just for my knowledge, so a lease surrender is ... so the 20-odd or 25-odd centres that you've earmarked today, they are all ... I mean are they essentially on holdover, is that what it means? They were ready?

Gary Carroll: Yeah, no, none of them were a holdover. They all had a lease that had some period to run. The amount of the period varied from 12 months up to a very long period. So none of them were on holdover where we were able to, obviously, just give one month's notice and hand back the keys. That wasn't the case for any of them.

John Hinde: Okay. And so sounds like you should have ... as you exit them you'll be exiting for a small loss with this portfolio, then, the smaller portfolio.

Gary Carroll: So our focus, if we're looking to surrender the lease is to come up with an exit cost that we think is reasonable, based on the lease time to expiry at the amount of the rent and the losses that we're incurring. And that's, as you can imagine, a balancing exercise.

John Hinde: Yeah.

Gary Carroll: And the engagement level varies by landlord.

John Hinde: Yeah. Thanks very much, Gary.

Operator: Thank you. The next question comes from Gareth James with Morningstar. Please go ahead.

Gareth James: Oh, hi guys. Just came to get your thoughts on the outlook for demand and supply, or more for supply. Just looking at the data seems to imply that supply is still pretty strong, and I'm talking in terms of number of places being added. I've got it currently running at about 4.7 percent per year.

Yeah, so what are your thoughts on that going forward and potential impact on G8?

Gary Carroll: Yeah, thanks, Gareth. Good question. And we set out in our investor preso in the appendix, an overview of the supply-demand dynamics.

Quarter two, this year, as you'd expect, was a low point, given the COVID environment, but it did rebound and for the year basis, we're seeing supply growing at about the same as historical levels, so certainly agree with your initial assessment that supply growth hasn't materially abated. And our initial forecast is it won't abate over the coming period in any significant way, even though we do think occupancy off the the back of employment conditions will be at a lower level.

The pleasing thing from our perspective is the impact on our exact network has been substantially reduced. Lots fewer centres opening within a couple kilometres of a G8 centre, so specific impact to G8's been okay; it's actually been more positive over the last 12 months.

What that will look like moving forward is anyone's guess, which is actually the impetus behind us accelerating our improvement programme, though evidence still suggests that we improve our quality and we have a stable engaged team that is a really good defence against supply coming on board. So we are looking to up the pace on an improvement programme to de-risk any supply related risks.

Gareth James: Okay, thanks. And just if I could clarify something ... you talked about a $12 million dollar provision in 2020, I think it was.

Gary Carroll: Yeah.

Gareth James: You were talking about relating to the remediation. So just to clarify, does that mean that the total figure that you've quoted is ... the rest is going to fall in 2021?

Gary Carroll: No. So that's a great question, thank you. So the remainder of the figure falls into prior years. And there'll be two steps here and Sharyn will no doubt correct me, but the amount relating to 2019 will flow through when we do our year end accounts in terms of a restated 2019 number. The amounts relating to prior periods before 2019 ... because this goes back to July 2014 in terms of the review period ... they will flow through in terms of an adjustment to our opening retained earnings.

Gareth James: Sure. And just one final one for me. So just on the 27 centres that I think you were talking about are going to be sold ... I was just wondering with the underlying EBIT figure that you've given, I guess that excludes losses from those centres?

Gary Carroll: I wish, but no. No. So we haven't ... the underlying EBIT includes the $12 million dollar provision for employee payments, but it has all of our centres in a ... they will only come out when they exit the network.

Gareth James: Right. So why was the $12 million dollar provision included in underlying EBIT?

Gary Carroll: Because it's wage cost. So yeah, it's relating to the costs of back payments relating to wages under the remediation programme. And so it is the estimate based off the review work that we have done to date. The final amount will clearly be confirmed as we work our way through the remediation programme.

Gareth James: Sure. Okay. Thanks, guys.

Operator: Thank you. The next question comes from Aaron Muller with Canaccord. Please go ahead.

Aaron Muller: Good day, Gary. Hi, Sharyn. Look, just in terms of the remediation programme, can you just give us a bit more colour about the issues around insufficient documentation?

Gary Carroll: Yes. I'm sure as you can appreciate, Aaron, we have quite a complex operating environment where we've got regulated ratios on a per room basis across 470-odd centres with daily movements in attendance levels and team member levels. And our team adjusts on a daily basis to ensure we remain within ratio and with the mix of workers that we have full time, part time and casual, under the existing award arrangements any changes to those people's hours, particularly relating to part time, need to be documented.

So we ask someone to do less hours than is under their contract, to meet the demand, etc., ... or more hours ... then those need to be documented. And our review has highlighted that in a number of cases that documentation is not immediately evident; we now need to commence a more detailed centre by centre team member analysis to see if that documentation is, in fact, in place. If it is in place, then that's one set of actions. If it's not in place, then we clearly need to make a payment to that employee relating to that.

So yeah, I think the overarching root cause is around scale and complexity in a regulated environment with moving parts that occur on a daily basis.

Aaron Muller: Yeah, okay. And the range that you've provided in the $12 million for this year ... how confident are you that that won't change?

Gary Carroll:	Right. It's a preliminary estimate based off a diagnostic review ... which has been a very detailed diagnostic review ... but I can't say with any certainty at this point in time until we get into record by record, team member by team member.
Aaron Muller:	Sure.
Gary Carroll:	We've got a reasonable basis for the estimation, but we now need to go and complete the work.
Aaron Muller:	Yeah, okay. And look, just on the network growth strategy going forward, should we assume it's going to be skewed towards greenfields and is this the main area you'll be looking to deploy capital?
Gary Carroll:	I think the answer wouldn't have changed from the last couple of years, Aaron, in that we'll balance all the elements of our strategic programme, improvement programme, divestments and sensible network growth. And we're agnostic between brownfield and greenfield. There's pluses and minuses to both. Brownfield, you get the opportunity to get an ... existing earning stream and providing all the other metrics and key factors that we look for in that centre stack up; supply demand, quality of team. Then we would pursue that. It just so happens that to date, there have been very few, really none attractive brownfield opportunities for us to assess.
Aaron Muller:	Yep. Okay. Just going back to just picking up a question by Tim Plum, just on the wage costs, your wage to sales ratio going up next year, are you assuming that the divested centres are still in the business?
Gary Carroll:	Yeah, we have not made any firm assumptions about the timing of the exited centres because they're always subject to negotiation, so we haven't.
Aaron Muller:	Sure. Okay. Okay, great. Thank you.
Operator:	Thank you. Once again, if you wish to ask a question, please press star one. The next question comes from Tim Plumb with UBS. Please go ahead.
Tim Plumb:	Hi, guys. Just a couple of followup questions from me, if that's all right. Gary, can you maybe talk about the pipeline of inquiries for next year? How's that looking relative to this time last year? And how do you feel that places the business heading into calendar year '21?
Gary Carroll:	So far we're ahead of last year in terms of our lead pipeline, Tim. So inquiries, tours, et cetera, we're tracking ahead of last year. And so we're certainly pleased with where we're sitting, that the overall position will only be fully ascertained. The key January, February period is still an important period for us. As you know, because you've been covering this sector for a long time, really splits into two periods. People that secure early, certainly volume's

been pretty good. And then there is quite a significant volume that comes through at the very start of the year in January, into early February, and the lead times on those are compressed, but they also contribute a fair amount to our starting position in February. So I can't talk to how that's looking at this point. Certainly progress to date's been pretty good.

Tim Plumb: Got it. And I know you guys put it, I think it was on slide eight, could you give us a sense, what are the actual numbers? So 75.5 I think was inclusive of Victoria. If you looked at all other states, excluding Victoria, what was that number and what was that number down relative to last year?

Gary Carroll: Yeah, so I'd probably frame it in terms of how we're tracking against last year. So you'd say statewide Queensland and WA are reasonably equivalent. New South Wales, a touch behind but pretty solid. And Victoria is still ramping up. It's still got a little bit of a gap on last year. And ACT is actually our worst performing centre, and that's actually a GA issue around senior manager turnover. It's only nine centres as well in terms of our overall network. So you'd say if you exclude Victoria, people have absolutely closed the gap, although we are still slightly behind last year. Victoria is catching up, but it's a little way behind the rest at this point still.

Tim Plumb: Great. And just one last one, those 27 other performing centres, I mean $14 million is across the whole portfolio of 52 or whatever it is. And I know that there's some larger, bigger loss vacant greenfields included within that portfolio. How do we think about the EBIT loss of the 27 that you're currently looking to exit out of that 14?

Gary Carroll: Yeah. I can't really give you a number on that, Tim, because it does vary. And also their results slowing through into next year will be clearly subject to how they start the year from an occupancy perspective. So it would be a real guess at this point in time. Clearly can't do an arithmetic average and say it's about half. The best thing we can do for people is to give you an update as we go, and we can quantify the impact as we're rolling along.

Tim Plumb: Got it. Okay. I might try and squeeze one last one, if that's all right. 98 mil of EBIT includes 12 million provision. So that's 110 compared to what we thought it was before we knew about that issue. On my numbers that compares to about 70 mil of adjusted consensus for pre AASB. So a pretty big beat. And that's November year to date. How do we think about a typical December EBIT contribution for this sort of business?

Gary Carroll: Well, in a trading update, we wanted to focus on where we're tracking year to date. We weren't going to provide any guidance as to how December looks. We are still, in our view, in quite a volatile operating environment. And if things happen, as we've seen, even in South Australia reasonably recently, that can knock things around. So we're not providing guidance as to how December looks. We're clearly happy with what we've done November year to date, and the business is performing well in all the fundamentals, but we're just not going to be providing a number at this point.

Tim Plumb:	Got it. Great. Thanks, guys.
Operator:	Thank you. The next question comes from James Bales with Morgan Stanley. Please go ahead.
James Bales:	Thanks, guys. Just for clarity, should we be including the 12 million provision in the underlying cost base that we extrapolate going forward? Or with the new systems, does that go away?
Gary Carroll:	Certainly our intent, James, is that the new systems will mitigate the impact of the results of the review. So we're not anticipating any material increase in future wage costs.
James Bales:	Okay. Got it. Thanks.
Operator:	Thank you. There are no further questions at this time. I'll now hand back to Mr. Carroll for closing remarks.
Gary Carroll:	Well, thanks, everyone, for your time today. No doubt we'll be catching up with a large proportion of you in the next day or two. And thanks once again for your time and your questions, much appreciated. I'll let everyone get back to their day. Thank you.
Operator:	Thank you. That does conclude our conference for today. Thank you for participating. You may now disconnect.

[END OF TRANSCRIPT]