Evolve Education Group Limited

Chair's Address

Annual Shareholders' Meeting, 31 July 2018

Welcome/Introduction

Good afternoon everyone and welcome to the fourth annual shareholders' meeting since Evolve Education Group Limited was listed on the NZX in December 2014.

Joining me today are my fellow directors Norah Barlow, Lynda Reid, Anthony Quirk and Grainne Troute.

I would also like to extend a warm welcome to Rosanne Graham, Evolve's new CEO. Rosanne has only been in the role for four weeks but is already making significant headway in getting the process for an improved Evolve underway.

I would also like to acknowledge Stephen Davies, Evolve's CFO.

Today's annual meeting is an opportunity for shareholders to meet and hear from Rosanne. The focus of this meeting will be as much about where to from here as on our performance during the last 12-15 months. Last year's under-performance has been well covered in various market announcements, the FY18 result release in May and in the Annual Report. I believe we can take these as read and focus on the future, with any specific questions relating to FY18 able to be covered in question time, as required.

The agenda today will include my Chair's address, Rosanne's CEO address, and the opportunity for shareholders to ask questions on the operations and management of the business. I will also touch on recent media speculation about ownership matters. We will then cover the formal resolutions as per the Notice of Meeting and questions relating to the resolutions.

Voting for the resolutions will be by poll. I would ask that questions relating to the resolutions are made at that stage of the meeting please.

The results of the voting will be announced to the NZX later today.

The last year, but also looking forward

Firstly, I will outline where we see the company's position, with reference to the past year and previous expectations but, more importantly, looking ahead as best we are able to - given that our CEO is new to the company and is still in the initial stages of confirming plans, strategies, priorities, and actions to help steer this company towards a stronger future. Shareholders will be interested to hear from Rosanne at today's meeting and she will outline her impressions and intentions for Evolve.

I want to emphasise that the board remains confident about the potential for this company. There is a timing challenge to our recovery which we will refer to but we continue to believe in the underlying business model.

For a range of reasons that we now have focus on, the company has not been executing well, but we are clear that the business performance can be improved substantively. The remediation process will inevitably take some time and will also require further strategic investment in both operating and capital expenditure in order to recalibrate the company.

Focus of the Meeting

As already emphasised, the focus of this meeting needs to be more about the future than the past. The "where to from here" question.

First of all, we need to stop the deterioration in earnings performance. This can be done but will take some concerted effort by management over the next 6-12 months.

Secondly, we need to start the rebuild, with the benefits of that expected to become apparent over the next two years.

We then need to restart business growth. This growth phase should start in early FY20, once the important recovery steps have been implemented.

Evolve is a geographically spread and diverse business with a mix of very well-operated centres and lesser-performing centres. Each early childhood centre is effectively a separate business unit, so overall management and effectiveness of the network is key to success.

We have not executed sufficiently well in terms of management effectiveness, structures, systems, infrastructure and support. These matters are within our control, they can be fixed and we are in that process.

But shareholders can rightly ask, what about direction and momentum?

What is the plan and the strategy?

We believe strongly that we can see a good future for Evolve - the key elements of our plan can be summarised as below:

- Appoint a strong CEO with excellent people leadership skills and experience in the education sector who has proven business acumen and capability
- Mandate the CEO to reset the management of the business and the structures, reporting lines, and accountabilities
- Ensure that sufficient human and financial resources are made available to fix the problem areas, including premises and physical resources
- Enhance marketing (enrolment) effectiveness
- Ensure better staff engagement (leading to improved staff satisfaction and child/parent retention)

- Turn the operational/financial performance around and recover ground that has been lost, then
- Move forward on our growth objectives, through enhancements to existing centres and new, purpose-built centres, in combination with a careful and considered approach to acquisitions.

This recovery and rebuild plan goes beyond the 2019 financial year. The NPAT potential for this year is already negatively impacted by a slow start and the inevitability of embedded trends not abating for a few months yet as Rosanne gets to grips with what needs to be done.

Our formal re-planning is yet to be undertaken under Rosanne's leadership but we see no structural reason why the business cannot return to previous levels of profitability and then beyond. Consequently, we are committed to investing in this business to fix the issues and problems over a two to three-year period and to achieving recovery and growth. This is the mandate we have given Rosanne as CEO.

Ownership Interest

We are aware of recent media speculation in relation to the ownership of Evolve. We have received enquiries from a number of interested and credible parties about the potential value of the company under different ownership.

The board and members of senior management have spent time during the last nine or so months responding to queries from a range of parties about the performance and medium-term outlook for the business.

The board can confirm that it believes that there has been, and continues to be, credible interest in the ownership of the company, although there is no certainty that any transaction will eventuate from this interest.

We are not in a position to say more than this at this stage, or to comment on any particular rumours. Should anything tangible eventuate it would be weeks rather than days away.

Staff Acknowledgement

At this stage of the meeting I would like to acknowledge our staff. This company has a large number of very hard-working and very committed staff, delivering excellent services to a large number of under 5s and their parents. Our people can be proud of what they do and how they go about their responsibilities and the board would especially like to acknowledge their efforts over the past year.

However, for various reasons, the company has not been able to execute particularly well on supporting and assisting the efforts of those on the front-line. Our staff survey has shown that a significant percentage of our front-line staff do not feel well-supported by the company and we are not where we need to be on staff engagement and satisfaction.

One of the key advantages of Evolve, as a larger organisation, should be its ability to leverage its scale to facilitate better investment in the business in terms of learning and development, resources, and curriculum strength. Centralised head office functions should be able to efficiently handle the majority of the non-educational essentials such as property maintenance, recruitment and marketing and provide effective and responsive support and assistance across a range of other important aspects such as Ministry liaison and health and safety. Improving the delivery of services provided by head office is a key focus for the company, as this will relieve the burden of non-educating activities and take the load off our teachers thereby improving their satisfaction and reducing distraction.

Teacher shortages and Government funding

Looking at the sector more broadly, teacher shortages are creating serious difficulties for everyone in the education sector. The company's cost base is being impacted by an excess of demand over supply for qualified teachers. These shortages are also impacting on rostering and meeting MOE minimum ratios for full funding at some centres.

And, as everyone is well aware, the lack of any uplift in government funding rates for more than four years, to offset the rise in teacher salaries and overall inflation, has put significant pressure on the sector. The new government has announced a 1.6% funding rate increase, but not effective until 1 January 2019.

The Last 12 Months

Looking back on last year, it is fair to say that we expected to do better than we did. At last year's annual meeting we noted incremental slippage in the business in terms of centre occupancy and the critical wages to revenue ratios. However, we under-estimated this incremental slippage and our ability to regather it.

In fact, the slippage continued and gathered some additional momentum. We initially believed that the business needed some modest adjustment but we have since found that our issues were more entrenched than we expected and are taking longer to address.

Immediately following the 2017 annual meeting the company's then CEO resigned and Mark Finlay stepped into the breach. We thank Mark for being willing to do this and for his sterling efforts to start to turn things around.

Mark's tenure achieved a more detailed knowledge and awareness of where our problems lie and what needs to be done about them. Mark was able to identify that the underlying issues within the business had been accumulating progressively and when they started to impact into the earnings base, were shown to be more pervasive than anticipated.

We are confident that we now have a good handle on what these issues are and we will ensure that the requisite skills and capabilities are applied at senior executive level in order to reset the business. We now better appreciate that it will take some time and special effort to remedy the drift but Rosanne is a strong and highly capable CEO and we are confident that the dynamic within the business will improve.

New CEO: Rosanne Graham

One of a board's primary responsibilities is to make sure the company has the best available CEO in place and that the CEO is held accountable for company performance.

This key responsibility led the board earlier in the year to commence a search for an experienced and passionate CEO with proven leadership performance in the education sector. There are few suitable candidates in the New Zealand market who meet this specification, or who have the aptitude and capability to take up the Evolve CEO role in what is a highly scrutinised and challenging sector.

We have a diverse range of stakeholders who monitor our performance very closely, through varying lenses and the board is acutely aware of the need to meet all of the competing requirements of these various stakeholders.

We are delighted to have been able to appoint Rosanne as Evolve CEO. As you will hear for yourselves today, Rosanne is highly motivated and strongly driven to achieve success for Evolve. I will hand over to Rosanne shortly so you can judge for yourselves.

Centre Portfolio - Acquisitions and Developments

Getting our existing centre network into better shape is a key priority, and a comprehensive review of our centre portfolio is being undertaken. We know that we have some high-performing centres, some centres that are achieving quite well, and others that are underperforming their potential.

Our review of our centres has identified that we have overdue maintenance and capital improvement to attend to. The obvious connection here is that well-maintained physical environments have a direct bearing on the engagement and motivation of staff and therefore on parent and children enrolment and retention, with a direct link to occupancy and revenue.

We need to continue to invest to enhance the high performing centres and address the issues impacting on the lesser performing ones, and, in some cases, consider divestment and better deploying that capital elsewhere. It goes without saying that all of our centres need to be in good physical condition and well led and managed. Barriers to entry for smaller operators are quite low and with an increase in supply, parents can be quite selective in their choices. Our centres, simply put, have to be better than the alternatives.

As previously advised, our preference is towards new, purpose-built developments in good locations. The advantages are clear with no goodwill, new and therefore good quality buildings and facilities and no after-acquisition fall-out or discontent. But new developments typically build earnings over a 2-3-year period, so there will be a drag on earnings as these properties come up to speed. Earnings are impacted during the development phase, which we will continue to call out when we are reporting financial performance.

Board

Anthony, Lynda and Grainne were newly-appointed directors at last year's annual meeting and Norah and I have been on the board since commencement.

All our board members are high-commitment directors and provide a strong diversity of experience, expertise and input to board considerations. The board is working closely with Rosanne, especially during her phase-in period.

Norah and I are standing for re-election at todays' meeting and we will speak to these resolutions at that stage in the agenda.

Looking Ahead

Looking ahead is difficult. In a volatile environment of a declining earnings trend and a new CEO only in the role for four weeks, it is difficult to predict our FY19 earnings with any degree of confidence - until Rosanne has had sufficient time in the business and we have had the opportunity to plan our priorities and timings with her.

We cannot ignore that we have disappointed our shareholders and ourselves by not turning things around thus far. We were previously confident that we would be able to and we haven't.

So why do we think there is a better outlook now? We have challenges ahead and the future is uncertain. But we know that a lot of what we need to do (and can do) is to execute better, and we will ensure that we have the right expertise in key roles within our management structure to achieve that. We believe that we have now fully identified the key business performance drivers, and that many of the fixes are within our control. And we are optimistic that we have a government in place that wants to support our sector and is very mindful of the lack of teacher resourcing and overall funding that has been harmful to all involved in this important sector over the last four years.

Outlook and Earnings Guidance

Let me turn to the outlook for the year and our earnings guidance. In the current circumstances, with a new CEO and only four months into the financial year, it is difficult to provide specific guidance as to potential earnings for FY19. Furthermore, we are of the view that the current financial year is less relevant to the performance of the company than the two-year period thereafter.

The occupancy decline we experienced during the 2018 financial year has continued into the current year. In FY18 the average occupancy across the base network of centres was down 2% points from 82% to 80%. This occupancy decline has continued by a similar magnitude in the current year. Evolve's business model is extremely sensitive to small changes in occupancy levels, given the fixed nature of the cost base, particularly staffing and rents.

The strategies that Rosanne will outline shortly are intended to arrest this decline in occupancy and regain lost ground. But those actions will then take some time to positively impact results and there will inevitably be some additional operating expenditures needed in order to secure better revenue performance. We expect that performance will start to improve once momentum around enrolments and occupancy has been achieved, and results are expected to be tracking better in the final quarter of FY19 and on into FY20. What we cannot accurately forecast at this time is how soon the remedial actions can deliver stronger earnings.

That said, we are committed to being transparent with our shareholders despite the uncertainties and volatilities that confront the company. Our current best estimate is that, if the business tracked through to the end of FY19 at current occupancy levels (and excluding additional expenditures for remedial strategies), underlying earnings (Operating EBITDA) for full year 2019 would be in the order of \$3m-\$5m down compared to last year's \$21.6m.

I would stress that this estimate, which is the best available at this time, will inevitably be subject to variation and we will be looking to provide more robust guidance at the half year result in November. I would also like to reinforce the point that the underlying business potential is not necessarily well represented by the earnings outlook for the current financial year.

Handover

That concludes my remarks, let me now hand over to Rosanne to address the meeting.