G8 EDUCATION

AASB 16 LEASE STANDARD

G8 Education[ltd]

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This purpose of this presentation is to provide a detailed overview of the impact of the new lease accounting standard (AASB 16 Leases) on reported financial statements

G8 Education's 2019 half year result is scheduled to be released on 26 August 2019

INTRODUCTION

KEY PRINCIPLES OF AASB 16

IMPACT ON G8's FINANCIAL STATEMENTS

CONCLUSION

INTRODUCTION

- Historically, G8 disclosed future lease commitments in the notes to the financial statements and reflected lease expenses in the income statement

- AASB 16 effectively brings the present value of future lease commitments on to the balance sheet with a corresponding ROU Asset.

- Lease expenses are replaced by depreciation and interest expense which are equal over the term of the lease

- The new standard applies to financial reporting periods commencing 1 January 2019 i.e. CY19 H1 financial statements

G8 - Key Takeaways

No impact on cashflows, dividends or debt covenants

- Implementation of AASB 16 will have no impact on:
  - Cash earnings and cash flow
  - Debt covenants and facility headroom
- No impact on strategic plans
- No impact on appetite or ability to grow the network
- Shareholders can expect the same cash dividends as they would prior to the adoption of AASB 16

- Significant non-cash impact on the reporting of financial statements:
  - Leases are recognised on the balance sheet including options (where exercising the option is ‘reasonably certain’)
  - Income statement changes:
    - Lease expense replaced by depreciation and interest
    - EBITDA and EBITDA margin increase
    - EBIT and EBIT margin increase
    - NPAT and EPS decrease
- The extent of the impact varies by entity and is dependent on the life of the lease profile of a company, transition method selected, borrowing rates and lease expenses as a proportion of the income statement as a whole

Transition Approach to AASB 16

- A number of options are available for AASB 16 adoption:
  - Fully retrospective, modified simplified or modified retrospective
- G8 will apply the modified retrospective method:
  - Comparative year (2018) accounts are not restated
  - Incremental borrowing rate applied as at the date of transition
  - Lease liability and ROU asset will differ on transition with the variance accounted for in retained earnings
  - Low value and short-term leases excluded
- The historical acquisition profile of the Group makes it difficult for the fully retrospective method to be applied as G8 has taken over a large number of leases part-way through their terms.

- Comprehensive and detailed process undertaken by G8:
  - Two year programme in preparation for implementation
  - New lease management system implemented
  - All leases individually reviewed
- Robust internal and external review of G8's application of AASB 16 principles and initial sample testing of calculations as part of the 2019 audit

AASB 16 Balance Sheet Impact

- Under the new leasing standard both an asset and liability are brought on to the balance sheet
- Balance sheet impact:
    - Lease asset: Right-of-Use (ROU) of underlying leased assets
    - Lease liability: present value of lease payment obligation
- Over the lease term, the asset and liability reduce as follows:
    - ROU asset depreciate evenly on a straight-line basis
    - Lease liability decreases by cash rental payments less the interest expense portion, which reduces over time as the liability reduces
- The asset and liability may revalue during the lease term due to changes in rent (e.g. CPI), lease modifications or lease renewal expectations

Example: A single lease with fixed annual rent increases

*Graph reflects lease from commencement rather than transition date

AASB 16 Income Statement Impact

- Current lease expense, including rent, replaced by:
  - Depreciation of ROU asset on a straight-line basis
  - Interest expense on reducing lease liability balance

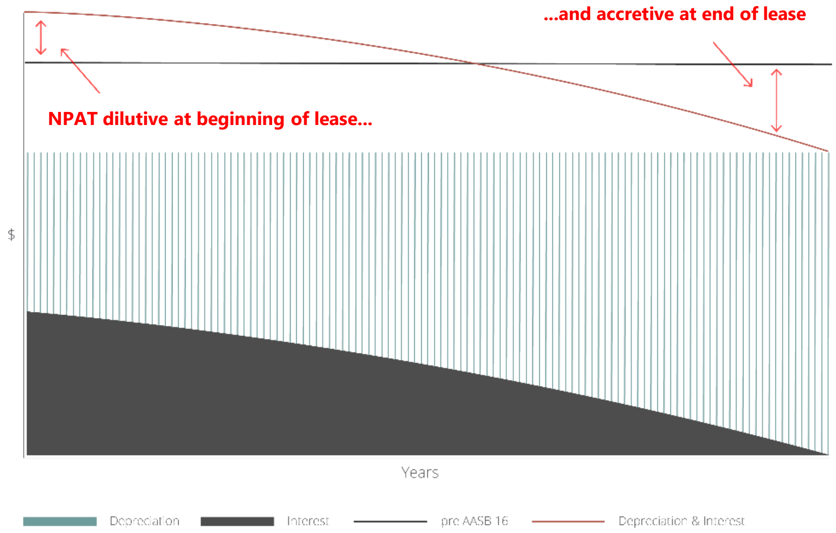
- Over the life of any lease, the total expense to the income statement is the same as total cash rental paid both pre and post AASB 16

- EBITDA increases as the rental expense is removed

- EBIT increases as the rental expense is removed and only partially offset by increased depreciation

- The impact of AASB 16 on NPAT and EPS varies by entity and over time:
  - Interest expense is higher in earlier years and reduces over time, resulting in NPAT and EPS being lower at the beginning of a lease and higher at the end of a lease
  - The net accounting impact of AASB 16 is to bring forward the lease expense to the earlier stages of a lease term, which reverses over the lease term

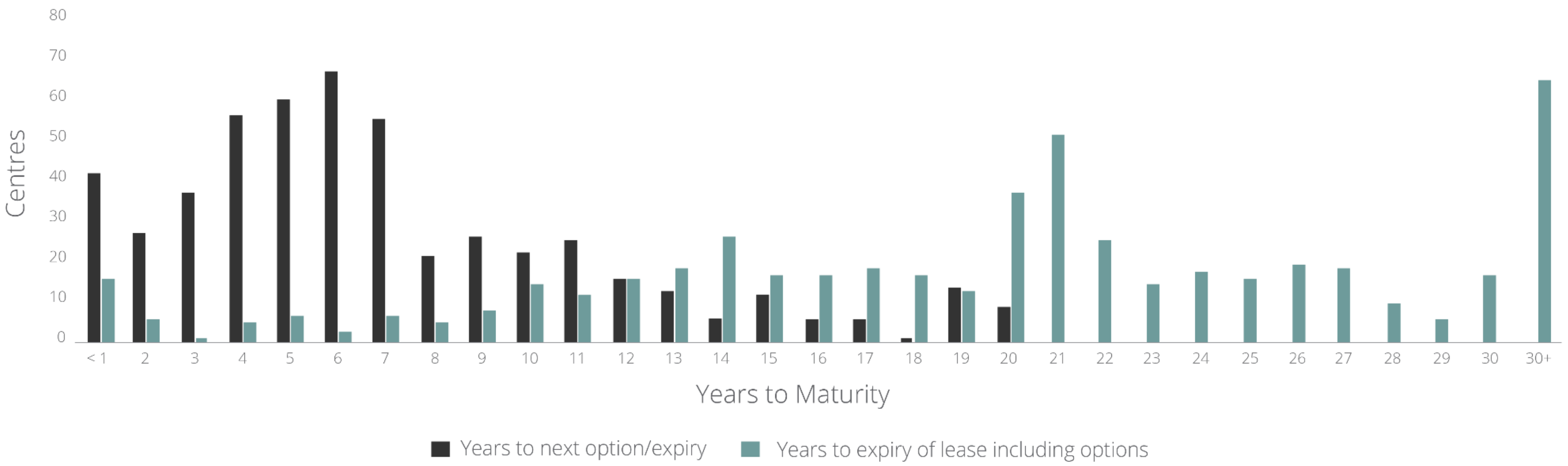
Example: A single lease with fixed annual rent increases



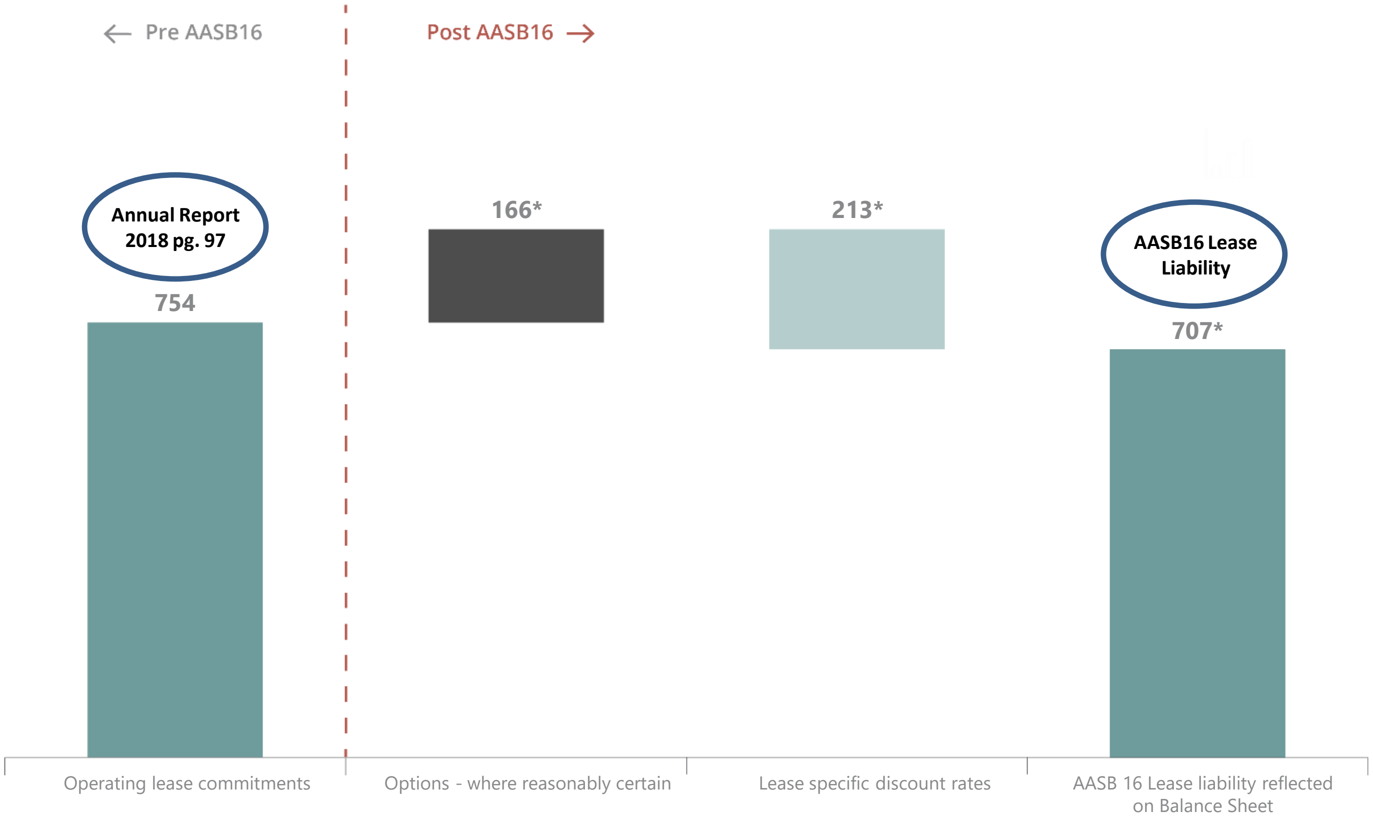
- NPAT dilutive at lease commencement and accretive towards lease maturity
- In an aggregated lease portfolio, the lease profile and on-going exercise of options subdues this effect

G8 Centre Lease Portfolio

- As at 1 January 2019, G8's property portfolio comprised:
  - 554 property leases
  - Weighted average lease expiry (WALE) excluding options – c. 6 years
  - WALE including all options – c. 20 years



AASB 16 Lease Liability as at 1 January 2019 ($m)



* Based on unaudited management estimates

AASB 16 Net Assets as at 1 January 2019 ($m)

* Based on unaudited management estimates

AASB 16 Income Statement Impact - CY18 Pro Forma

G8 Education Ltd

- Lease rental expenses replaced by depreciation on ROU asset and interest on lease liability
- Given G8 has adopted the modified retrospective approach and will not be restating prior years, the tables demonstrate **the impact of the current CY19 lease portfolio under AASB 16 on the CY18 income statement**
- Disclosures will provide transparency on both a pre and post-AASB 16 basis as the transition to the new standard is absorbed
- The seasonality of G8 earnings will result in a higher relative impact on H1 earnings as the above expenses are broadly incurred evenly throughout the year

CY18 $m	CY18 Pre-AASB 16	AASB 16 Non-cash Impacts * Exclude Lease Expense	Include Depreciation	Include Interest	CY18 Post AASB 16#	AASB 16 Impact	
Revenue	**858**				858		No change
Other expenses	(600)	2			(598)		Vehicle leases
Occupancy expense	(109)	105			(4)		Property rental
EBITDA	**149**	**107**			**256**	**107**	**EBITDA increases**
Depreciation	(16)		(77)		(93)		Depreciation (straight line basis)
EBIT	**133**	**107**	**(77)**		**163**	**30**	**EBIT increases**
Finance costs	(29)			(44)	(73)		Interest on lease liability
Profit before tax	104	107	(77)	(44)	90		**PBT reduces**
Tax (30%)	(32)	(32)	23	13	(28)		
Profit after tax	**72**	**75**	**(54)**	**(31)**	**62**	**(10)**	**NPAT reduces**

AASB 16 - Seasonal Impact *

Income Statement $m	CY18^	1H18^	2H18^
EBITDA	149	56	93
EBITDA AASB16 #	256	109	147
EBITDA Change %	72%	96%	57%
EBIT	133	48	85
EBIT AASB16 #	163	63	100
EBIT Change %	23%	32%	18%
NPAT	72	24	48
NPAT AASB16 #	62	19	43
NPAT Change %	(14%)	(19%)	(11%)

* Based on unaudited management CY19 AASB 16 estimates

Represents unaudited, non-IFRS information in respect of 2018 year

^ Decimals not displayed, % movements calculated on whole numbers

AASB 16 Cashflow Statement Impact - CY18 Pro Forma

- The AASB 16 impact is a reclassification of cashflows between operating and financing activities with no change in net cash flow
- No change to strong cash generation
- Cash conversion of EBITDA to gross operating cashflow will be measured on a pre-AASB 16 basis

CY18 Cash Flow Statement $M	CY18 pre-AASB 16	AASB 16 Impact	CY18 post-AASB 16
Cash flows from Operating Activities			
Payments to suppliers and employees	(695.2)	107.6	(587.6)
Interest paid	(23.0)	(44.0)	(67.0)
Net cash inflows from operating activities	**105.9**	**63.6**	**169.6**
Net cash outflows from investing activities	**(92.8)**	**0.0**	**(92.8)**
Cash flows from Financing Activities			
Repayment of lease liability	-	(63.6)	(63.6)
Net cash outflows from financing activities	**(7.0)**	**(63.6)**	**(70.6)**
Net increase in cash and cash equivalents	**6.1**	**-**	**6.1**

No change to cash generation or net cash flow

AASB 16 Gearing Ratios

Gearing Ratios

$M	CY18	AASB 16 Impact	Proforma CY18
Net Debt	**305**	**705**	**1,010**
Underlying EBITDA	153	107	260
Net Debt/EBITDA (x)	**2.0**		**3.9**
Net interest	29	44	73
EBITDA/Net Interest (x)	**5.3**		**3.6**
Fixed cover charge (x)	**1.7**		**2.1**
Gearing ratio (%)*	**25%**		**53%**

Fixed cover charge ratio = EBIT + rent expense /interest expense + rent expense
Net leverage ratio = Net debt / EBITDA
Gearing ratio = Net debt / Net debt + shareholders equity

- AASB 16 affects the inputs to various gearing ratios however the absolute gearing level of G8 has not changed
- Notwithstanding the AASB 16 impact on gearing ratios, arrangements are in place with lenders to ensure that there will be no impact on borrowing facilities or covenant headroom under facility agreements

Conclusion

No impact on G8's cashflows, dividends or debt covenants

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Q&A