
THE INVESTMENT OPPORTUNITY IN THE UK NURSERY MARKET

Market snapshot

The UK full-day nursery market is worth £5.5bn and has grown 4% pa since 2013. Its highly fragmented nature and attractive underlying dynamics drive increasing investor interest in the sector. In 2018, this led to over 200 reported acquisitions – both by large chains and by smaller, local operators (10% of deals were single-site purchases).

The UK is widely viewed as the “gold standard” in childcare and this has also meant increasing investment from overseas in recent years, with US-based Bright Horizons acquiring Asquith and European Les Petits Chaperons Rouge making several acquisitions since 2017, among others.

High competition for assets to either add to existing portfolios or to help new investors

develop a platform is resulting in some toppy (albeit polarised) valuations. Nevertheless, 58% of nurseries remain single-site operations, so, despite the growing deal activity, there remains significant opportunity for further consolidation.

So, what does great look like and what should investors be looking for?

Estimated split of the UK nursery market by group size

2016



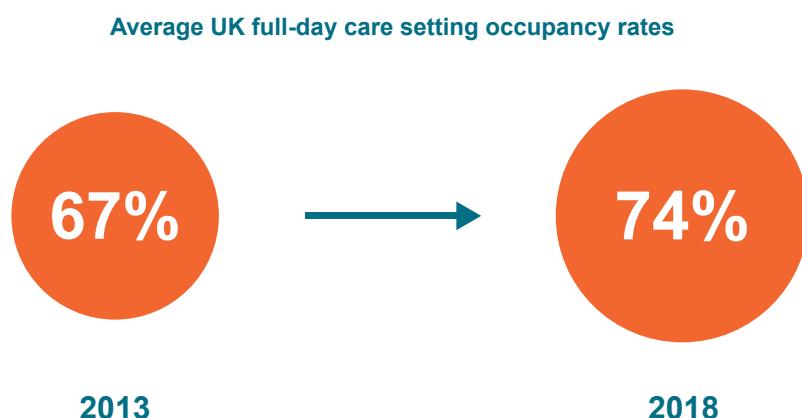
2019



Source: LaingBuisson

Attractive market dynamics

There are 5m children in the UK under the age of 5 yet only 1 in 8 are in full-time formal nursery care (and part-time attendance is common amongst younger children). Despite this, occupancy rates have been steadily increasing and there are some compelling trends as to why penetration should improve.



Source: LaingBuisson

1. Increasing focus of government policy

While there are views that the government's 30 free hours policy does not go far enough to help those parents who need it the most (and is often described as a discount to those that can already afford nursery fees), the manifestos of the three major parties do incorporate nursery-care funding, which demonstrates it is an important topic on the agenda.

2. Shift in perception of early-years care

Early-years care is perceived as an increasingly important component of education and recognition of this is driving a transition from informal to formal care. For children, the leap from nursery to school is

a large one. The sector is addressing this (with government guidance per EYFS) by creating a greater learning and educational focus and getting children school-ready within formal childcare settings at an earlier age.

3. Increasing age and employment rate of mothers

Women are waiting until later in life to have children. Having already established a career, these mothers tend to have higher income and therefore a greater tendency to use formal early-years care. Driven by cultural change and supportive employer policy, the demand for nursery places is growing.

What does a great nursery look like?

Nurseries are operationally complex and there are several components that contribute to success.

The location

While parents will travel for a great nursery, convenience is important, and most families tend to live within 5 miles. A prime location, for example near large/new housing developments, will be popular with young families. Higher household income and employment rates will accommodate higher average fees and lower levels of funded childcare, positively impacting on margins. Good commuting routes and nearby transport links will be important, especially for inner cities. The quantity and quality of existing supply, and the tendency for local schools to offer early-years care, will also need to be considered.

The property

First impressions are important – the property needs curb appeal and easy access with adequate parking on premise or nearby. Rooms should be configurable so that occupancy can be optimised as children transition from babies, through toddlers, to pre-school rooms. Security of tenure is crucial and, while freehold is desirable, a suitably long leasehold is also realistic. Features that make the setting unique (eg a large garden, an indoor slide, etc.) also help to differentiate the nursery.

The policies and procedures

A nursery requires a scrupulous safeguarding culture, including a fast and transparent reaction to incidents. Staff quality and the ability to implement is vital – the ethos of a nursery will drive a team to deliver safe and quality childcare. Strong and consistent communication with the workforce, parents and all regulatory agencies is vital for stable nursery operations that parents can trust.

The people

The workforce is a nursery's key asset. It requires people who are passionate and well-motivated and as an investor it is necessary to embrace and nurture this culture.

A nursery needs to value a leadership philosophy where managers have autonomy and responsibility and are encouraged to be entrepreneurial. It needs to be the childcare provider of choice not just for parents but also for the workforce. Recruitment and retention should go beyond remuneration and focus on career progression, ongoing training & development and perks such as discounted/free childcare. Recognition is hugely important in harnessing a culture of passion and quality – this may translate into programmes such as employee of the month. Staff qualifications, statutory compliance, employment contracts, turnover, vacancies and other key workforce KPIs are key to understanding the quality of the nursery.

The brand and reputation

A nursery benefits from a clear identity and the above factors (although non-exhaustive) will ultimately contribute to its brand and reputation. Word of mouth and parental recommendation are critical in decision making and a strong waiting list is a good indicator here. Good or outstanding Ofsted ratings are a fundamental requirement and will be a first port of call when parents are looking into childcare options. However, there are many ways in which a nursery can differentiate beyond its Ofsted rating, not least through the use of technology to streamline operations and communications with parents, and by offering flexibility for the modern workforce.

Post-investment considerations

Value retention and growth needs to put staff culture and quality at the centre of every decision. Apart from gaining scale to benefit from multiple arbitrage, building a differentiated offering to appeal to millennial parents is key for driving value.

Retaining value

A major consideration is the extent to which the owners are the heart and soul of the nursery. A charismatic and innovative owner may be responsible for a considerable amount of goodwill which drives retention of both key

personnel and parents. An exiting owner will therefore need to be carefully managed, and while staff changes may be necessary, continuity, stability and honest communication will optimise workforce and parent retention.

Driving value

Assets must be worked hard by developing (or retaining) a strong leadership team, ensuring quality and continuing to build scale. Valuation polarisation presents an obvious opportunity for multiple arbitrage, but there are other ways in which investors can create value:

- Increase capacity – reconfigure existing nursery, consider a mezzanine floor, extension.
- Renovate / refresh the property based on child-centred design principles.

- Introduce or improve value-add services to meet growing parent expectations, particularly for the millennial parent. This will help in increasing occupancy and achieving higher average fees.
- A nursery could consider the following when looking to improve its service offering:
 - Longer opening hours
 - Building up school-ready skills
 - Innovation in product offering (bilingual settings, use of technology etc).
 - Distinguished onsite chef/nutrition
 - Outdoor space

In a nurseries roll-up, synergies don't exist to the same extent as in other sectors that have seen consolidation driven by private equity investment, although back office functions can be integrated to a limited extent. Driving real value is more a matter of playing the long game – achieving scale at a sustainable pace, while maintaining quality and reputation consistently across the estate and creating a unique selling point for the nursery beyond simply good Ofsted ratings.

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