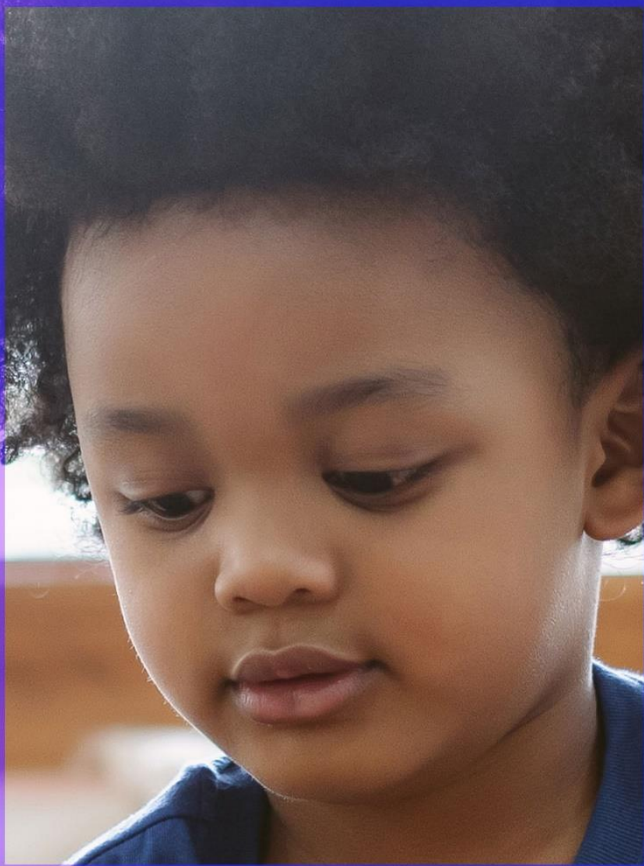
KPMG

Navigating the post-Covid UK nursery market



Provider strategies for the new normal

September 2022

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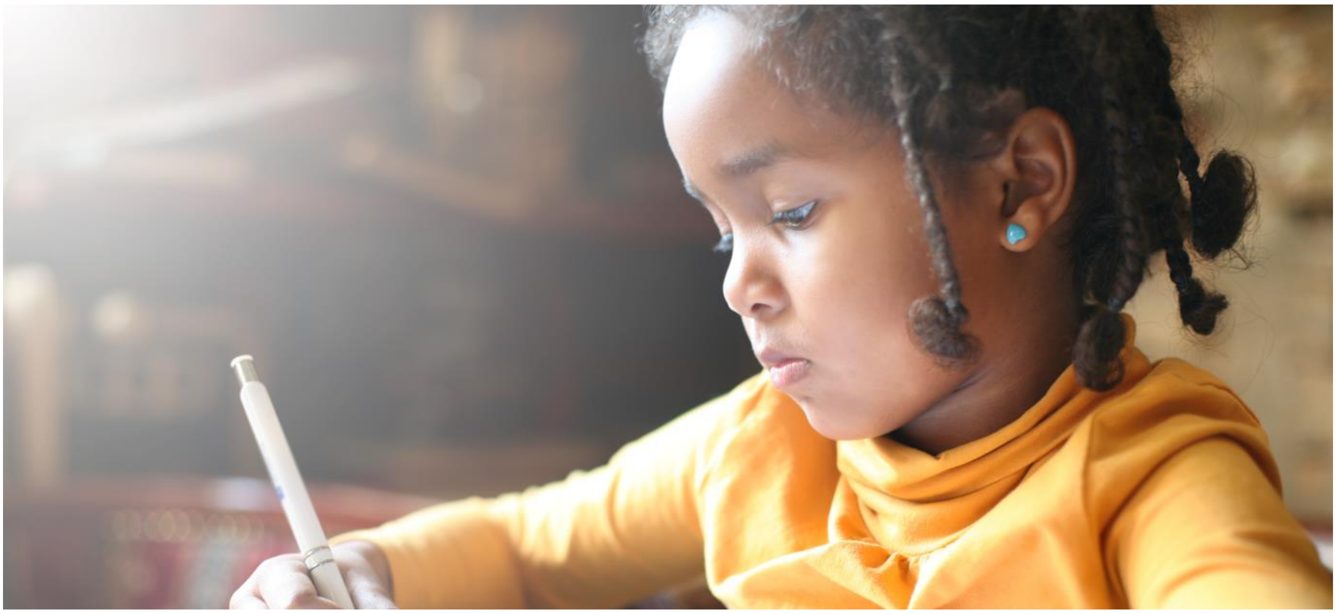
Contents

Has Covid broken the longstanding UK nursery market value creation story?

Before Covid, there was a clear value creation playbook for operators in the UK nursery market. Then the pandemic hit, disrupting the market and sparking widespread concerns around the sector's recovery in the future. When the dust settled, would the traditional value creation dynamics still apply?

We wanted to understand the impacts in detail – so we commissioned primary research to understand parents' perspectives on how the market has changed and what conclusions are drawn and lessons learnt.

With over 750 parents responding in H1 2022, this research is highly relevant for nursery leaders, current and potential investors and potential market entrants who want to plan for the future with confidence. Our findings give a detailed understanding of parent attitudes and how they will impact what good looks like for the future value creation story for UK nursery operators.



The pandemic changed many aspects of work and life forever – so how far does that include the nursery market? How much of the traditional value creation story has it left intact?

We wanted to find out and really understand the impacts of Covid in detail. Not just the impact on volumes, which was top of mind for most, but also the less discussed implications on pricing, mix and usage patterns.

Whilst operators and investors can take comfort from most of our findings, there are some early warning signs that conditions could tighten, particularly for groups, and these will require navigation.

We are delighted to share the key findings here, along with our views on what this means for the future of the sector.

— Adam Thorpe, Strategy and Performance Transformation Partner, KPMG and Ewan Robertson, Strategy and Performance Transformation Associate Director, KPMG

Why you should read this report

Valuable insights into:

- Demand dynamics and the underlying drivers behind them.
- Changing parental attitudes that can help you enhance your value proposition.
- Usage trends and how these have changed through Covid.
- The pricing outlook and how to continue to drive value in the face of inflationary challenges.

The tried-and-tested nursery buy-and-build story

The UK nursery market has a long track record of successful buy-and-build strategies over a sustained period of time. For example, the emergence of two super-groups (Busy Bees and Bright Horizons) as well as a number of small- and mid-sized private equity backed platforms have increasingly consolidated the market in recent years.

The consolidation playbook typically goes something like this:

01 Acquire small group/single site nurseries in a highly fragmented market;

02 Invest and professionalise to give an initial price and volume boost in acquired sites;

03 Achieve longer-term organic growth on the existing portfolio by passing through fee increases, supported by investment in sites and branding;

04 Repeat!

After an initial efficiency gain from professionalisation post-acquisition, the focus is almost always on top-line growth; and this has historically been relatively easy to achieve as acquired sites were typically, owner-operated, lifestyle businesses offering plenty of upside once plugged into a more formal infrastructure. Whilst some believe that this could be to the detriment of a more personal touch, it would generally be expected to lead to an uplift in margins.

…and then Covid hit

Initially, (as in most sectors) Covid had a huge impact on the UK nursery market, with lockdown meaning closures and reliance on government support. Subsequent lockdowns had less impact as education was somewhat protected, and the focus quickly shifted to recovery.

But, even as the immediate Covid impacts subside, we are still living through unprecedented times, with increasing inflation exacerbating cost and staffing pressures that is driving sector divergence. This is leaving some parents struggling with access to affordable childcare, and putting pressure on provider margins.

In this context, a number of key questions are on everybody's minds – investors and owner/operators alike:

- How can I plan in this uncertain environment?
- Will volumes recover?
- Will people need nurseries given the 'hybrid working revolution'?
- Can I still pass-through price increases?
- What does all this mean for market growth and consolidation?

So what did we find?

The headlines… the fundamentals remain strong but the playbook got longer and arguably, more complex

Market resilience remains – After two disrupted years you can start to plan with confidence.

The recovery has been uneven and usage patterns have shifted – if Covid has taught us anything, it is that understanding individual site dynamics is more important than ever.

Parents have learnt to expect price increases – but there are some warning signs for chains in the mid-term who may need to work harder to achieve them.

The rising importance of education and socialisation are contributing to a broader set of value creation opportunities – these can drive value and justify (some) fee increases whilst continuing to demonstrate value for money.

The value creation playbook still holds in the new normal… but it got a bit longer, and, arguably, more complex!

Market resilience remains

The market outlook is strong:

- There is no significant dip in volumes… if anything volumes are up (with sector challenges being more focused on supply issues such as the workforce crisis)
- Parents reported a strong recovery in hours post-Covid (albeit with some exceptions on a site-by-site basis)
- Changes made by parents in nursery usage for their children were typically seen as permanent, suggesting they are lifestyle decisions rather than short-term fixes; nurseries can have more confidence in planning for the future

An uneven recovery

The recovery has not been uniform, with some interesting differences behind the volume headlines:

- Some local areas have come back more strongly than others – re-emphasising the need to understand granular site-level dynamics
- Contrary to our in-going hypothesis, private pay hours were reported (by parents) to have risen despite changing working patterns
- Usage patterns have shifted to a more even spread in nursery usage across the day and week – traditional 'shoulder periods' (less popular sessions) have rounded out with uptake in afternoons increasing (albeit remaining below that of mornings)

Price increases have become an accepted (albeit not necessarily welcomed) reality for parents

Parents have an in-built expectation of fee increases that has not changed due to Covid:

- Typically, we note that price increases are accepted if they are linked to specific events, such as paying staff a Living Wage or a rise in business rates
- But this acceptance will be tested in the mid-term as the cost-of-living crisis bites – so having a clear rationale for prices rises will be increasingly important
- The good news for providers is that there is a sticky customer base and price remains a second order factor when deciding which nursery to use
- However, some early warning signs are starting to emerge, particularly for groups. This should be in providers' considerations right now, not in two years' time

Shifting priorities driving additional value creation opportunities

The rise in the importance of Education and Socialisation add to an increasing number of ways nurseries can drive value:

- Our surveyed parents identified Investment in Education as an increasingly important factor for them in their use and choice of nurseries, and an important way to justify fee increases
- Indeed, a notable finding coming out of Covid is quite how much importance parents are giving to the role of nurseries in the Education and Socialisation of their children
- Understanding levers available to demonstrate value to parents will be increasingly important to justify mid-term fee increases against the backdrop of higher inflation
- This could arguably give chains, who typically have greater access to capital, a competitive advantage over independents, fuelling continued sector consolidation
- Outside of this, we would expect operators to have more focus on efficiencies in order to help to drive value and reduce operators' reliance on continuing to pass through increasingly difficult, inflation-beating price increases

The value creation playbook still holds in the new normal, but it got a bit longer (and more complex)

The old nursery playbook remains valid today but Covid, combined with the cost-of-living crisis, has added to its length and complexity. We think there are three key additions:

- Build a clear and compelling Value Proposition and shout about it so that differentiation and value for parents is clearer than ever before
- Dig even deeper into (post-Covid) local dynamics to tailor your proposition and market positioning accordingly
- Balance top-line growth with additional focus on operational excellence and quality, which are fundamental to drive growth whilst meeting parental expectations

01 Market resilience remains

Nursery leaders can start to plan with more confidence as volumes recover and market resilience continues

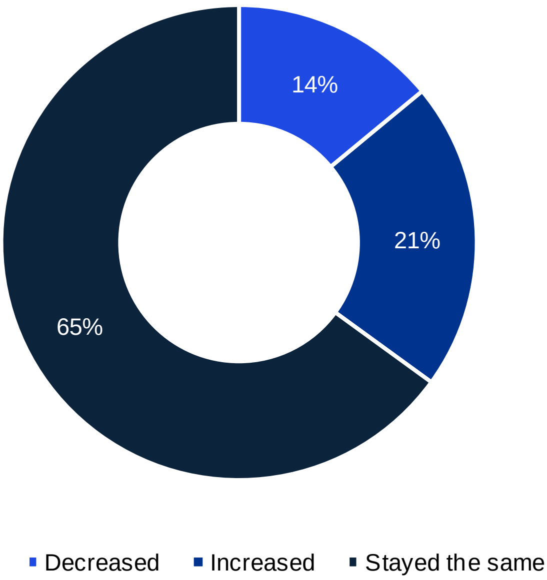
Strong volume recovery coming out of Covid

Initial fears around a reduction in demand for nurseries, given changes to working habits, seem to have been unfounded, with 86% of survey respondents having either kept their hours the same or increased them (often due to a funding or job change).

This is great news for the sector, and somewhat of a surprise given how much noise there was around volume concerns. Of those that had decreased their hours, hybrid working was given as the main reason in only around a fifth of cases.

> If anything, people value the benefits of nurseries even more post-Covid: they need the flexibility nursery care gives them, as well as appreciating the wider advantages of high quality nursery care in socialisation and education. You can't work from home surrounded by young children, just as you can't take them to the office. The hybrid working revolution actually supports demand for nurseries, rather than reducing it.
>
> **— Adam Thorpe, Strategy and Performance Transformation Partner, KPMG**

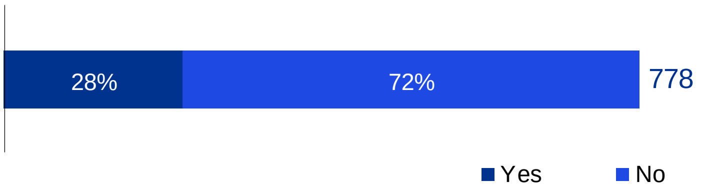
Have your nursery hours increased, decreased, or stayed the same in the last 12 months? (n = 417)



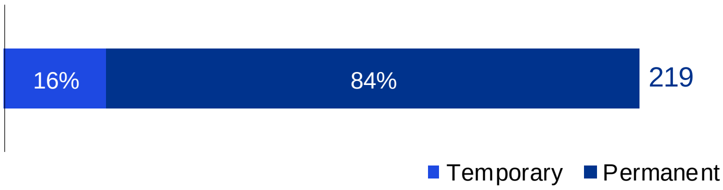
The 'new normal' looks set to stay, providing a more stable planning environment

There was concern that rapidly shifting working patterns would impact demand for childcare. What we have found, however, is that demand remains and where changes are being made, they are seen as permanent choices.

Are you considering changing the amount of nursery usage in the next 12 months?



Would this be a temporary or a permanent change?



Covid has shone a light on the wider benefits of nursery such as education and socialisation, and we believe this underpins the resilience in demand we are seeing through the survey results

Our survey shows that, generally, nursery usage choices are being driven more by longer term lifestyle decisions than from short-term fixes due to working habits. Indeed, where hybrid working was only cited as a reason for change in around a fifth of cases.

> Increasingly, nursery is being seen as much more important than just a place to put a child whilst you work. People want to realise the educational and socialisation benefits for their children. Covid has accelerated this trend as parents and children suffered through successive lockdowns. Coming out the other side, parents have a heightened appreciation of the importance of both education and social interaction, and this is providing nurseries with a real opportunity to add value to parents.

— Ewan Robertson, Strategy and Performance Transformation Associate Director, KPMG

02 The recovery has been uneven

The recovery has not been uniform, making it more important than ever to understand detailed site-level dynamics

Unsurprisingly, the recovery differs across regions and micro-locations

Whilst the sector as a whole appears to be recovering strongly, this has varied by region and by micro-location and so has impacted some sites and providers more than others:

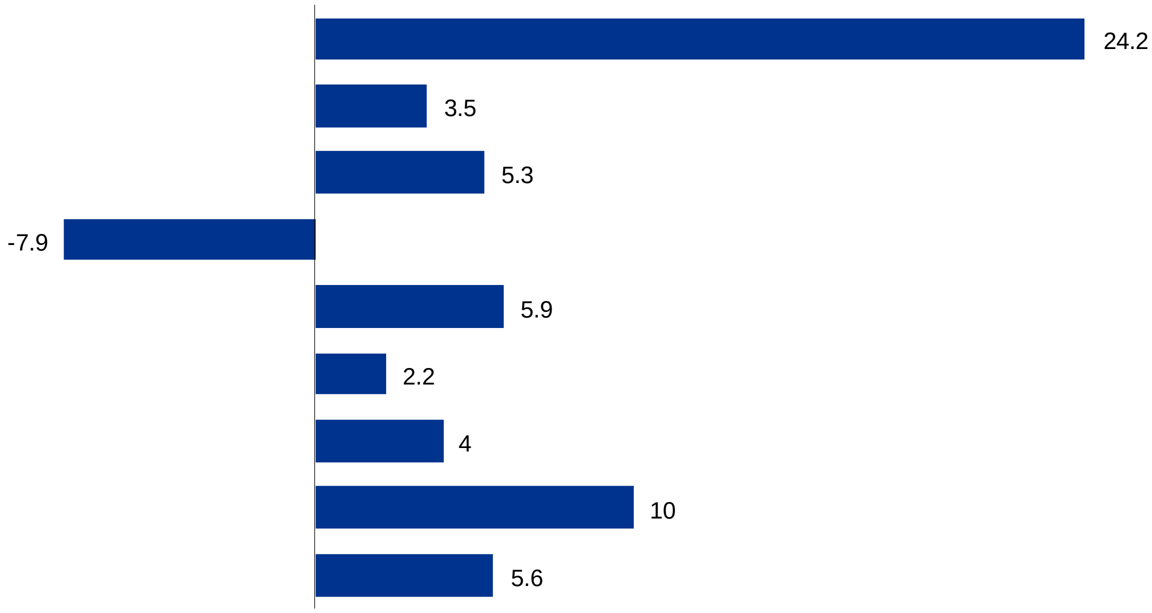
Survey responses suggest a strong recovery in Cities over the last 12 months, with 23% of urban dwellers saying they had increased their hours and just 8% decreasing

> [There has been] a bit of a bifurcation of sites coming out of Covid. Strong sites have already bounced back to pre-Covid levels.
>
> — Nursery investor

What did surprise us, however, was that the proportion of private pay hours had not decreased – if anything it had increased – a positive for providers

Our hypothesis going into this survey was that a small decrease in overall hours could have a disproportionate impact on providers' financial sustainability if it came largely from private pay hours. However, we were surprised to see that respondents did not report a reduction in private pay hours – if anything they had increased.

Movement in Pre- vs. Post- Covid Private Pay reported hours as a % of total hours by region



Note: Each bar represents the parental responses within a specific region. Detailed region by region data not published in this document

We believe this can be partly explained by changes in usage patterns

There has been a clear shift in nursery usage patterns, with demand over the day and week becoming more evenly spread post-Covid. This can benefit providers, helping them to achieve growth and operational efficiency because of the reduction in the number and scale of low popularity sessions.

Through our discussions with providers, we believe there are a number of main causes:

- Hybrid working patterns give people more flexibility on which days they are in the office and needing childcare – potentially resulting in a greater spread of demand across the week and a need for full day care (including afternoons)
- Even when working from home, many parents will still need childcare as it is not feasible for them to work with children of a young age around them
- Uneven demand recovery means high-demand nurseries can be firmer in selling less popular sessions as part of a package rather than individual sessions (for example, mandating that parents have to take the whole day to get a place)

Whilst this is clearly good news for providers, it highlights the importance of understanding local dynamics because the picture will vary from site to site.

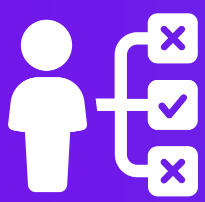
Shoulder period uptake pre- versus post-Covid (indicative)

Morning	MO	TU	WE	TH	FR
Pre-Covid					
Post-Covid					
Post-Covid vs Pre-Covid trend	Reduced	Slightly reduced	Reduced	Increased	Slightly increased

Afternoon	MO	TU	WE	TH	FR
Pre-Covid					
Post-Covid					
Post-Covid vs Pre-Covid trend	Notably increased	Notably increased	Increased	Notably increased	Notably increased

Key: Lower uptake Higher uptake

The chart above shows average uptake rates of morning and afternoon sessions by day, as reported by parents. Whilst mornings remain more popular than afternoons, it shows a clear rounding out of usage, reducing the variance between uptake in high-demand times and traditionally low-demand 'shoulder periods'. For example, whilst Monday mornings remain popular, its relative popularity has dropped as people go to the office on other days. Where people do use Mondays, however, more are using it for a full day, with Monday afternoons becoming more popular.



Key takeaways for nursery leaders:

- After two years of disruption and short term tactical fixes, the focus can start to shift back to longer term strategic planning (which will be particularly important to address staffing challenges)
- Understanding detailed, local site dynamics is more important than ever

03 Price increases continue to be an accepted (but not necessarily welcome) reality

There is still a market expectation of fee increases – but operators will increasingly need to justify prices to parents as inflation bites

Outside of specific short term factors…

3.2%

Average reported fee increase last year (as reported by parents)

66%

Of parents are expecting future fee increases(1)

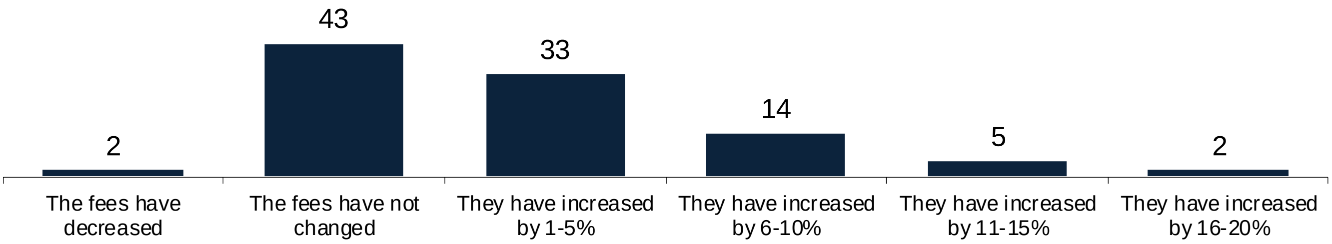
26%

Of parents are expecting a higher than historical fee increase. Beyond that justification is required

Whilst the survey was undertaken as the cost-of-living crisis was starting to emerge, and so will not reflect the full impact of rising inflation, it shows clearly that Covid has not stopped nurseries passing through the fee increases that are so fundamental to their organic growth stories.

Coming out of Covid, the sector has demonstrated its ability to do so with parents reporting a 3.2% average fee increase over the last 12 months

By how much has your nursery provider increased fees in the last 12 months? (% of total; n=304)



However, there was a big split in responses from parents with only 55% reporting a fee increase – re-emphasising the importance of understanding local dynamics at a site-by-site level.

Interestingly, groups have, on average, been able to achieve higher fee increases than independents – seemingly ahead of that expected through typical chain location profile (City centre and London and South East focus).

Note: (1) Due to the timing of the survey it does not fully reflect the impact of the cost-of-living crisis which has accelerated since the survey was undertaken. Therefore, survey results should not be taken as an indication of the quantum of future fee increases, particularly given wage inflation, but rather that the concept of fee increases being required is accepted by parents, and that there is little appetite for fee increases beyond the norm unless they can be justified by specific reasons or events.

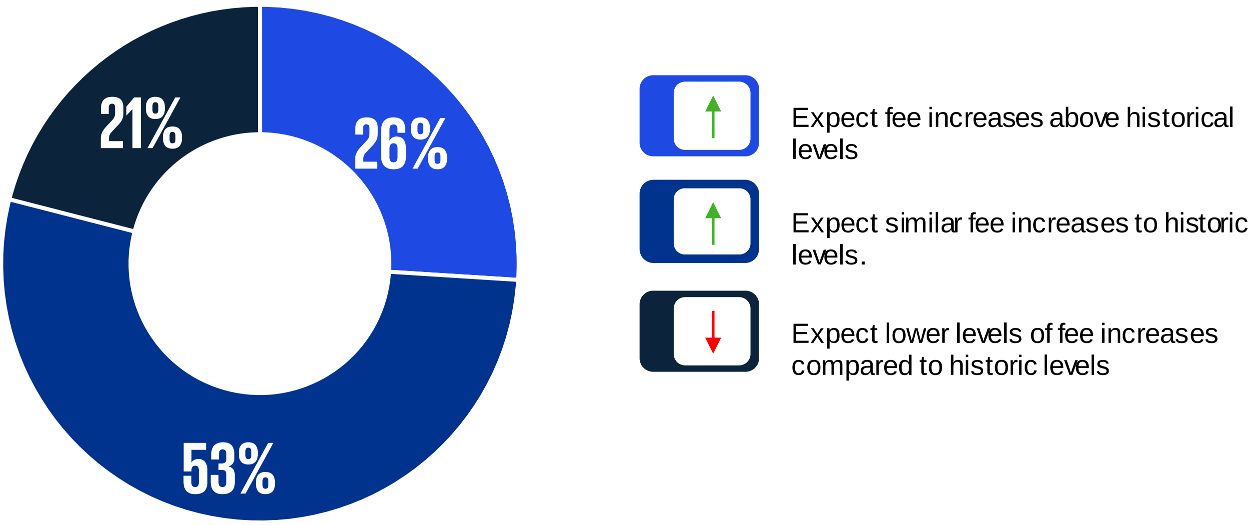
Average % fee increase in the last 12 months? (based on parents' perceptions from survey responses rather than a calculation of actual site increases)

Whilst not necessarily welcomed, parents do generally expect future price rises

Outside of specific events, price increases continue to be the norm with increases expected by two-thirds of parents – providing comfort to providers and investors that Covid has not broken the organic price growth pillar of their business models.

Whilst not necessarily welcome for parents, this will be comforting for providers facing inflation rates close to 10% and expected to go higher; and anecdotal evidence from providers suggests this is playing out already with fee increases (in some cases at much higher than historical levels) being applied to help offset staff cost pressures.

The ability to continue this in the mid-term remains unclear without clear justification, however.



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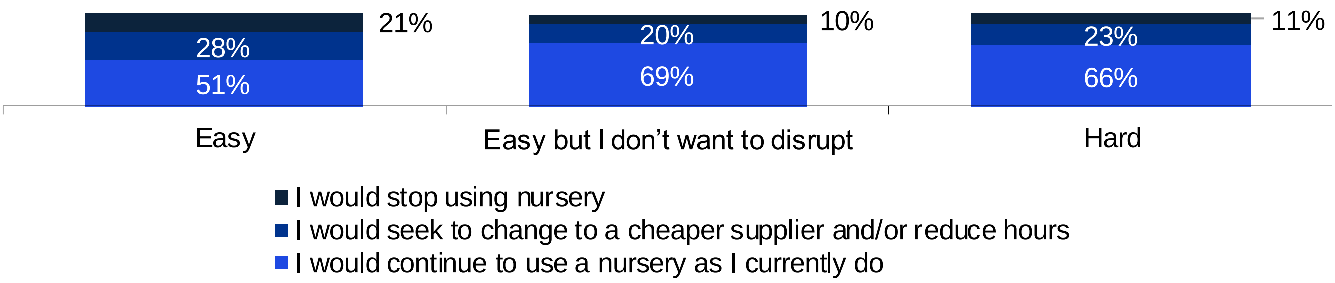
Parents understand the need for fee increases, particularly when they can see the benefits in terms of investment in education, the physical environment and, importantly, the nursery staff. In the current high-inflation environment this is enabling double digit fee increases at some sites

— Khush Purewal, Corporate Finance Partner, KPMG

Whilst this provides some comfort over the short-term capacity of operators to adapt to the inflationary pressures from the cost of living crisis, questions remain over the extent to continue the trend longer term

Despite parents' understandably low enthusiasm for fee increases, the customer base remains stable post-Covid, with 86% of respondents either finding it hard to change their childcare arrangements or not wanting to do so due to the resulting disruption for their child.

How easy would you find it to change your childcare solution? (% of total; n=417)



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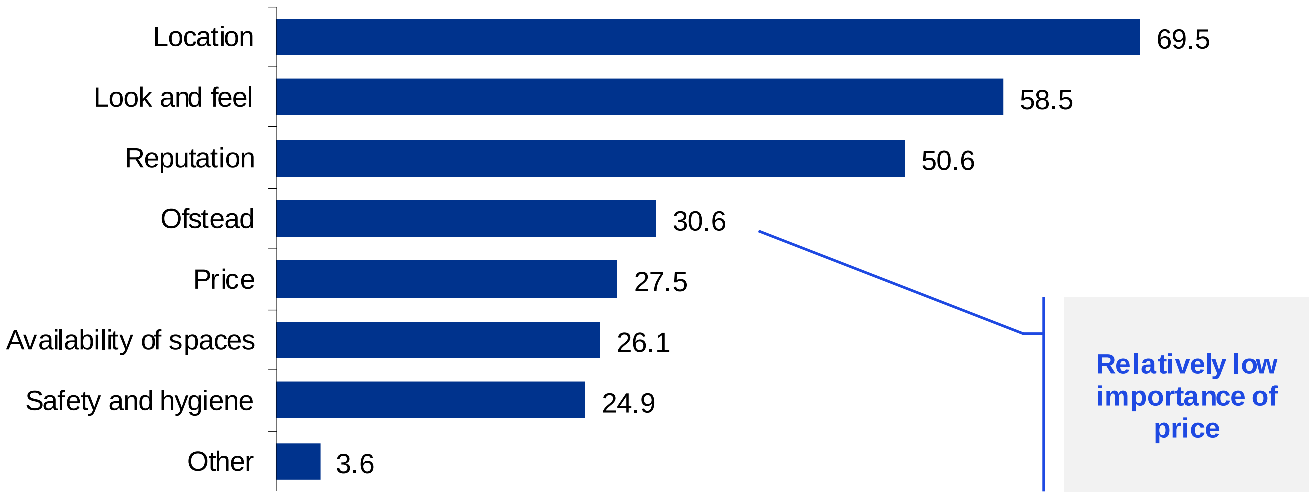
Price has never been the single most important factor in choosing a nursery and our survey shows this remains the case. This contributes to a sticky customer base that is generally accepting of price rises where they are justified and reasonable. Providers can therefore take some comfort around their ability to continue to pass through inflationary cost increases.

— Ewan Robertson, Strategy and Performance Transformation Associate Director, KPMG

Customer 'stickiness' is also supported by price coming relatively far down the decision-making order, with location remaining the top individual factor

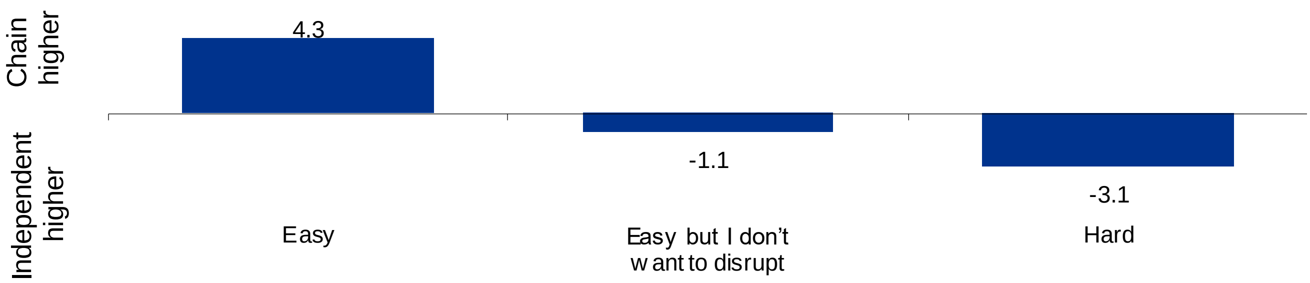
What are the top 3 factors that made you choose your nursery



However, some early warning signs are starting to emerge for groups. Mid-term price justification should be on providers' agenda now, not in two years' time

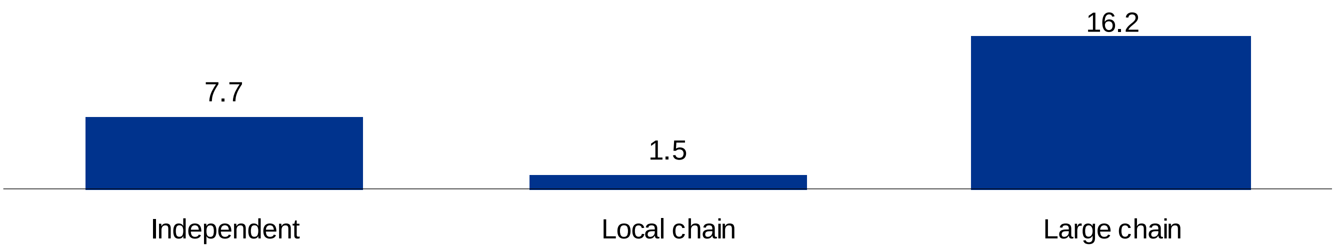
Surveyed parents who use chain nurseries were less 'sticky' and, for large chains, more cost conscious – potentially as a result of higher historical fee increases.

How easy would you find it to change your childcare solution? (Ppt difference between Independents and Chains)

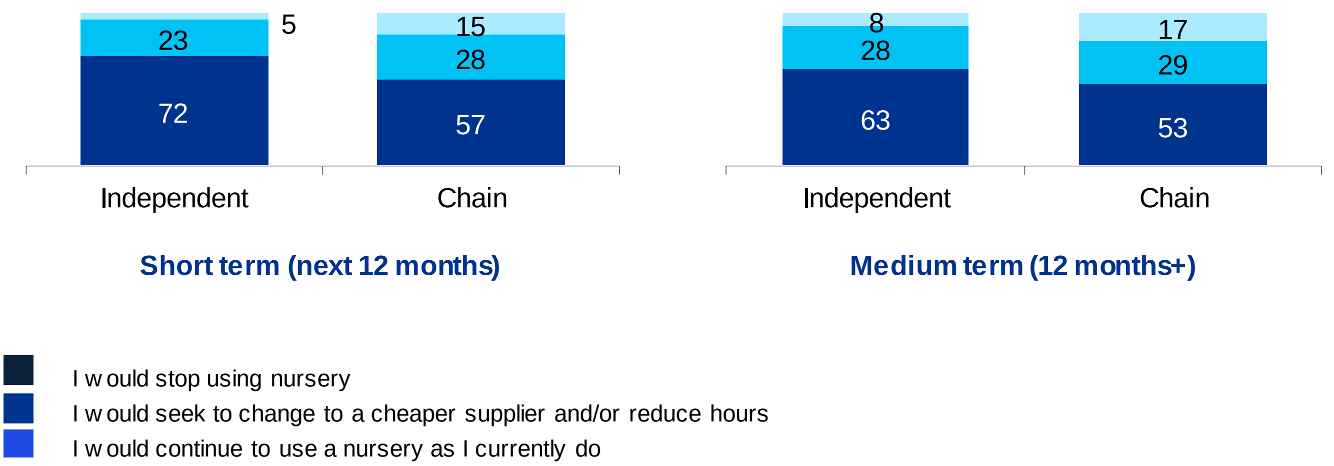


Parents of children using chains were more likely to consider changing nurseries than those using independents. Chains will have to work hard to keep their parents happy.

Proportion of participants identifying PRICE as the top Key Purchase Criteria by provider type (%)



Given the increased cost of living, how would you feel about future increases? (% split of responses)



> The signs are that chains will have to work harder than independents to justify price rises. This means strategic planning and thinking is needed now to shore up margins in the future.
>
> **— Ewan Robertson, Strategy and Performance Transformation Associate Director, KPMG**

As we know, moving is harder to do in reality than to talk about. Nevertheless, providers should be considering how to maintain mid-term price increases in the context of a high inflation environment now to avoid margin erosion down the line.

There are clear ways to demonstrate value and justify increases, particularly as parent priorities start to shift – and we look at these in the next section.

Key takeaways for nursery leaders:

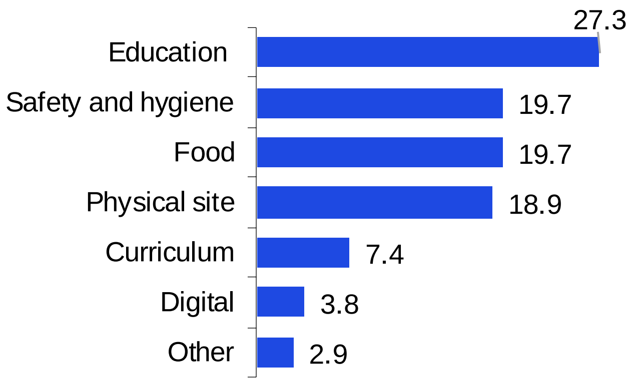
- There continues to be an embedded expectation of fee increases in the sector, normalised at 3% but able to flex when specific events provide justification (wage inflation, etc.)
- Customers remain sticky as parents do not want to disrupt their children s education and value other factors, such as location, above pricing
- There are some early warning signs around mid term price increases if inflation persists, particularly for groups, which will require providers to justify future fee increases by adding value

04 Shifting priorities driving additional value creation opportunities

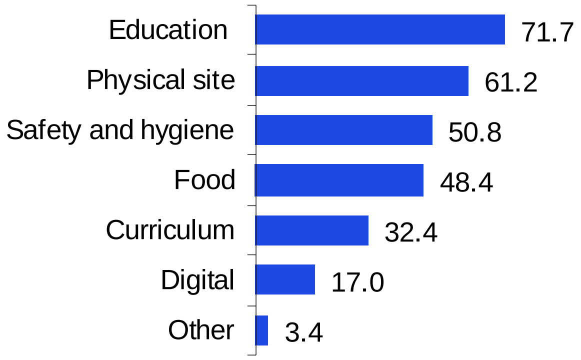
The rising importance of Education and Socialisation add to an increasing number of ways nurseries can drive value for both customers and providers

Our survey identified four key ways for providers to add value to parents and children, and therefore help to justify price increases – the standout being Investment in Education

Top
(% of respondents)



Top 3
(% of respondents)

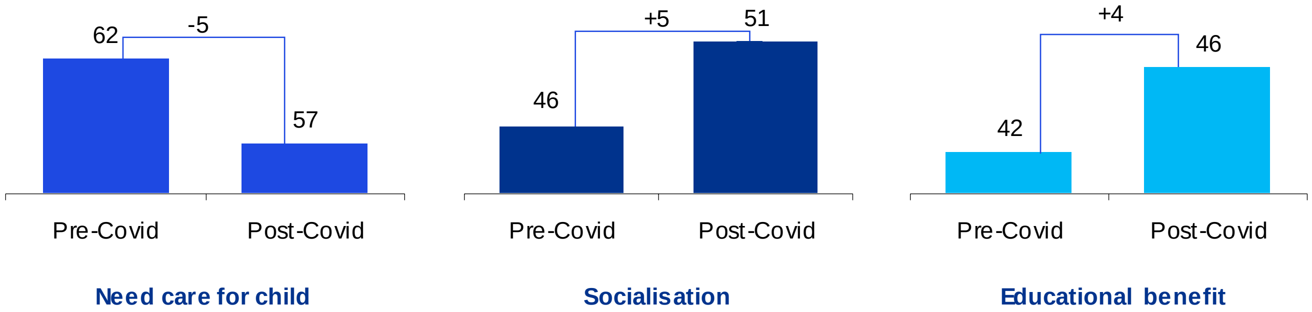


We see this as an acceleration, through Covid, of an existing (and international) trend. Parents were already increasingly conscious of the educational and social benefits of nurseries to give their child the best start in life. Covid brought this into sharp focus, with parents seeing their children starved of social interaction and their education repeatedly disrupted through lockdowns and self-isolation.

> After enforced periods of isolation through Covid, the importance of socialisation for children is now top of mind. Parents realise that nurseries can provide an environment to holistically enrich their children's development and lives
>
> **— Khush Purewal, Corporate Finance Partner, KPMG**

We think this has driven the shift in the reasons for nursery use through Covid, with our survey showing that whilst ‘Need for Care’ is still the primary driver, the relative importance of ‘Education’ and ‘Socialisation’ has increased significantly. This creates a clear opportunity to add value to parents and underpin reasonable price increases.

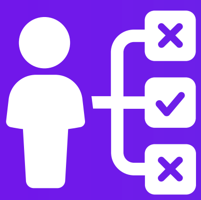
Why do/did you use a nursery?



This is a win-win area: providers can add value and maintain margins in the process; and parents and children benefit from a better experience and start in life.

Arguably, however, it plays better to chains – who generally have the financial backing that enables them to invest – than to independents, who often lack financial firepower.

> Unfortunately for some independents there is an increasing requirement to invest that may see some struggle. This could lead to more independents seeking to exit or sell to large groups who, in our experience, often have more financial firepower.
>
> **— Adam Thorpe, Strategy and Performance Transformation Partner, KPMG**



Key takeaways for nursery leaders:

- There are clear levers available for providers to add value and justify price increases investment in education is key to this given the rising importance of socialisation and education as purchase drivers

05 The value creation playbook still holds … but it got a bit longer, and, arguably, more complex

There are three key additions that providers should act on today

Our survey results point to a relatively positive outlook at a macro-level with strong volume recovery and continued acceptance of price increases.

The old nursery playbook remains valid today but Covid, combined with the cost-of-living crisis, added to it as customer preferences shift; affordability continues to be a concern that could impact mid-term pricing; and an uneven recovery has led to greater divergence in the market.

In our view there are three additional elements to add to the traditional playbook that must be actioned today to avoid issues down the line:

Build a clear and compelling Value Proposition and shout about it

Invest in your value proposition with a particular focus on quality and education. Articulate your story with parents so you can deliver value to them and be seen to do so (rather than being seen as profiteering).

> A clear and compelling Value Proposition is now essential. There are different ways to achieve this: by building local or national scale, supported by clear branding; by differentiating where scale is not possible; and/or by having a laser focus on quality and education. Whatever it is, it's got to be clear and well-articulated to parents.
>
> **— Ewan Robertson, Strategy and Performance Transformation Associate Director, KPMG**

Dig even deeper into post-Covid local dynamics

Understand post-Covid local dynamics in ever greater detail and adapt your strategy accordingly. This includes building granular data on price positioning at site level as well as understanding each site's ability to 'round out' shoulder periods. Reconsider your portfolio and M&A strategy with this in mind.

> Understanding local site dynamics, underpinned by data, has never been more important, particularly given the divergence in performance in the Covid recovery. Everyone does this, but those who do it well will win in the market.
>
> **— Adam Thorpe, Strategy and Performance Transformation Partner, KPMG**

Balance top-line growth with additional focus on quality and operational excellence

In addition to a historical top-line focus, identify and deliver operational excellence opportunities starting with low-hanging fruit.

> Fee increases alone are unlikely to be the answer. As the market matures and parents' finances are squeezed, proactive groups can support their customers and help maintain profitability by identifying efficiency savings. Given the relatively low focus on this historically, there is low-hanging fruit here that can benefit providers and parents alike.
>
> **— Adam Thorpe, Strategy and Performance Transformation Partner, KPMG**

About KPMG: Helping you achieve your nursery sector ambitions

KPMG's Education Strategy and Performance Transformation team can help you navigate the changing landscape and build a winning proposition to thrive post-Covid

KPMG has a comprehensive and modular value creation offer, including:

- Growth Strategy support
- Driving Exit Value
- Portfolio Optimisation
- Operational Excellence

Alongside our broader Deal Advisory teams, we also offer full-suite deal support, including:

- Commercial Due Diligence
- Operational Due Diligence and value creation potential
- Financial and Tax Due Diligence
- M&A support

Contact us

If you d like to discuss any of the topics covered in this paper and how KPMG can help, please contact:

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Appendix: Survey participants

About the survey…

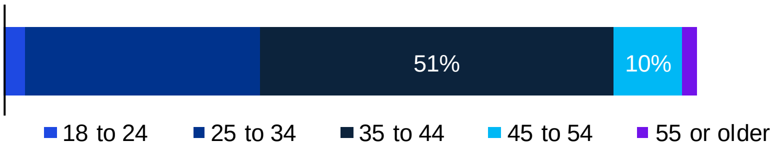
During H1 2022, we commissioned a survey of over 750 parents and spoke to a number of nursery chains, to understand the impacts of Covid on the UK nursery market and the extent to which it has changed.

Total survey participants

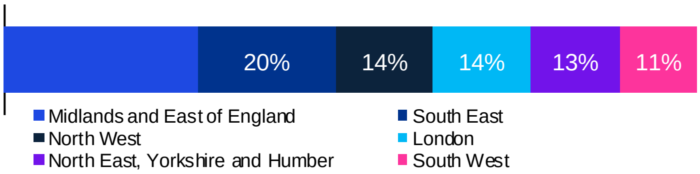
All participants had either used or were currently using a nursery

Gender

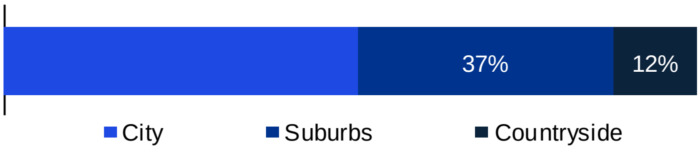
Age



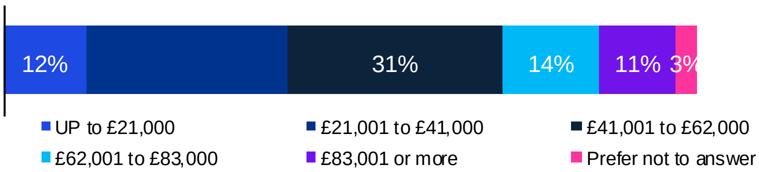
Region



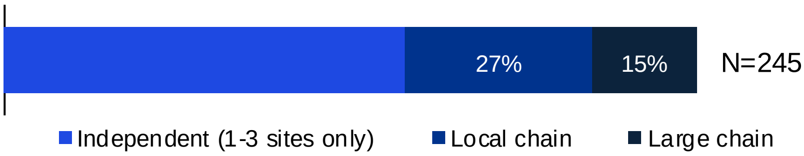
Location



Household income



Current provider type



Note: Not all respondents answered all questions and so sample sizes may be smaller for different questions/analyses

[Notes]

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