STOCKS DOWN UNDER

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# ASX Small Caps Stocks Down Under

*Patience is a crucial, but rare investment commodity.*

- David Dreman (b. 1936), Dreman Value Management founder

## MAYFIELD CHILDCARE

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**Stocks Down Under rating:** ★ ★

**ASX: MFD**
**Market cap: A$86.7M**

**52-week range: A$1.02 / A$1.48**
**Share price: A$1.35**

The childcare sector has endured a turbulent couple of years due to the pandemic, but Mayfield Childcare (ASX: MFD) handled it well and is positioning itself for a brighter future. In November, it acquired 14 Genius Learning childcare centres in a deal that took its portfolio from 22 centres to 36. The company is expecting a hefty boost to its earnings and after a few quiet years on the M&A front is clearly hungry for more deals in the future. But after a recent share price run, we think all the growth is priced in for the time being.

### Share price chart

*Source: Tradingview*

### Surviving the hard times

Mayfield is a childcare operator that listed on the ASX in November 2016, raising $24m at $1 per share. It was established as roll-up venture for several childcare centres, which were individually sold to the new company. Mayfield had 16 centres at the time it listed, all within 160 kilometres of Melbourne. Over the following five years, it slowly grew its portfolio to 22 childcare centres. 2020 was a tough year for the company and the childcare sector, but it emerged in a stronger position.

As the pandemic began in Australia, parents began to withdraw their children from childcare. By early April 2020, occupancy in Mayfield centres fell to under 40% of pre-COVID levels. While childcare centres were never ordered to shut, there were various periods in 2020 when they were only allowed to look after children of essential workers. The impact of COVID-19 on the childcare sector led to major federal government support. This included the ECEC Relief Package, which provided for the payment of 50% of regular childcare fees, and Job Keeper (which covered wage costs).

## Setting the scene for a brighter future

Mayfield was able to renegotiate rent reductions and modify its rostering system so that total centre wages costs as a percentage of revenues improved by 1.2%. And as COVID community transmission decreased, customers came back and occupancy had recovered to 87% by June 30 2020. It closed out FY20 (which is the same as the calendar year) with EBITDA of $6.8m and a NPAT of $4.2m - which were both ~11% higher than in 2019 – and after deferring its 2019 dividend in March, paid 7.71 cents a share in September.

2021 was a better year for the company and its shareholders. From a share price perspective, Mayfield shares grew over 24% in 2021 compared to an 8% decline in 2020. Although its EBITDA grew just 3.7% to $7.0m and NPAT fell 4.6% to $4.2m, its revenue from continuing operations grew 56.2% to $38.6m, which meant total revenues grew 7.9% despite government support being barely a tenth over 2020 levels.

In November, Mayfield unveiled the acquisition agreement with Genius, which expanded its footprint into two new states (South Australia and Queensland) and took its portfolio to 36 centres. The deal cost $39.2m and the majority was paid in shares, although the company also completed an $8m placement and a $1.75m Share Purchase Plan. The deal is expected to add $37m in revenues and $8m in EBITDA in CY22. Additionally, the pair entered a 5-year incubator partnership whereby Genius will find and develop childcare centres for sale to Mayfield – a move that indicates shareholders have more M&A to look forward to in the future.

And even though direct government support has all but dried up, some indirect support has remained. For instance, the government has removed the annual cap for families who get the Child Care Subsidy (CCS) - $10,655 per child for families earning over $190,015. And since March 2022, families with more than one child aged five or under have been entitled to a higher subsidy for second and subsequent children.

## Will the Genius acquisition live up to its name?

Consensus estimates for FY22 call for $82.1m in revenue and $16.2m EBITDA, which in both cases would be more than double FY21. Taking out the contribution of Genius, revenue would be $45.1m, up 16%, and EBITDA would be $8.2m, up 17%. FY23 consensus estimates are $96.3m in revenue and $19.3m in EBITDA, which if replicated would represent 17% and 19% from FY22. On this basis, the company trades at 14.2x EV/EBITDA and 7.8x P/E for FY23, which we think is reasonable.

Turning our attention to its peer, G8 Education (ASX: GEM). GEM has a far larger footprint at 448 centres, but was hit far worse by the pandemic, swinging into a loss in FY20. And while it returned to profitability, it's still below pre-COVID levels. Although it's EBITDA has remained positive, consensus estimates are for a 15% drop in FY22, from $252.3m to $213.4m. It sits at 7.3x EV/EBITDA and 19x P/E. Furthermore, G8's share price has dropped 66.3% in five years and has never reached pre-COVID highs, while Mayfield is up over 13% since its IPO in late 2016.

We think Mayfield shareholders have a lot to look forward to in the months and years ahead. But even with the expected growth and reasonable multiple we cannot give it four stars at the current price. From mid-March to the end of April shares gained 20% but fell from its 12-month high on May 3 and we don't think it has uplift from there. Considering this and the current market conditions it's two stars from us. But if it falls back to levels seen in February, it could be a chance for longer-term investors to buy in.

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