Kidicorp goes looking for a growth spurt [NZ] [1]

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EXCERPTS

You could say that both are related to playing, but even that is a big stretch to connect a gambling software venture with the business of caring for preschool children.

Yet despite that, and despite the fact that backdoor listings don't have a good track record in New Zealand, childcare centre manager Kidicorp chose to list via the shell of failed New Capital Market company Feverpitch International. It also joined the stock exchange's main board in the process.

Wayne Wright, who founded Kidicorp with his son, Wayne L. Wright, in 1996, says that while it had always been his intention to list, they were approached with the Feverpitch proposition which accelerated listing plans by a year or so.

"We didn't think we had enough critical mass in March last year," Wright sen. says.

"But we had a legitimate, thriving, expanding business. We're a real company with real prospects and a real bottom line."

He contrasts that with other instances where failed start-up companies are used to list another start-up which needs to raise capital.

Kidicorp hasn't raised any new capital, instead using its listed status to issue shares in part payment for acquisitions.

Hindsight suggests it might have been better to wait another year before listing. The company had forecast its earnings before interest, tax, depreciation and amortisation (ebitda) in the year ended March would be about the $2 million mark.

In the event, ebitda came in at just over $1.4 million.

But the shortfall isn't so surprising when you look at the company's expansion over the year. In March last year, it managed 13 childcare centres in the Bay of Plenty and Auckland which had licences to cater to a total of 800 children.

By the end of March this year, the company had 51 centres licensed to cater to 2170 children.

Wright admits the company had "a lot of bedding-in problems" associated with such rapid growth.

A large part of the shortfall reflects the fact that occupancy averaged only 70 per cent through the year, but the company opted to maintain its staffing levels with an eye to the fact that the childcare sector generally suffers from a shortage of qualified staff.

Wright says the company was also investing in staff training and upgrading the centres as well as building up management and IT systems to run them. By the end of March, occupancy levels had reached 75 per cent and Wright says the ideal across all the centres would be an occupancy rate between 86 per cent and 91 per cent.

While many businesses put strenuous efforts and serious money into branding, Kidicorp isn't one of them. The company name is only used at the corporate level while the centres operate under diverse names including Excel Early Learning Centres, Wattle Downs Early Learning Centres and Everglade Early Learning Centres.

"When we buy centres, we assume it's the community support that makes them sufficiently attractive for us to buy them. We don't change anything, we just take over the management," he says.

"We don't buy dogs with fleas as fixer-uppers. We buy performing centres and maintain them."

At first glance, the company's bottom line brings into question Wright's assertion that his business has "a real bottom line": it made a net loss of $11.6 million in the year ended March compared with Feverpitch's final loss of $3.6 million the previous year.

But the bulk of the loss reflects the company's decision to write off just under $11 million of goodwill, leaving $11.7 million in its balance sheet.

Kidicorp certainly has real revenues: $17.3 million for the year from running its childcare centres and another $3.7 million from property transactions.

(While the company doesn't intend to own the centres, it often has to buy the properties that house them. But it aims to only own them for a short period, selling them with long-term leases attached.)

One aspect of the annual report that might raise investors' eyebrows is auditor Ernst & Young's decision to flag a "fundamental uncertainty" in the company's accounts.

"The financial statements have been prepared on a going concern basis, the validity of which depends on achievement of forecast cashflows and continued bank funding via the credit facility," Ernst & Young says. The accounts don't include allowances for what might result should the forecast cashflows or bank funding prove insufficient, it says.

The directors also note that current liabilities exceed current assets by $4.9 million (current assets totalled $4.1 million at March 31 while current liabilities were just over $9 million).

Wright says this relates to the fact that the company receives Government funding of between $3 million and $4 million three times a year, and also relies on a revolving credit facility from Bank of New Zealand.

Chief financial officer Bruce Woodward says the receipt of the Government funding creates an accounting liability. While the BNZ facility is committed through to 2007, it is rolled over every four months, making it a current liability.

Kidicorp's total assets of $18.8 million (including $11.7 million in goodwill) compare with total liabilities of $13.5 million, leaving $5.3 million in equity.

But two weeks ago, the company announced a major change in its operation: it signed a contract with Australian listed childcare company Peppercorn Management Group to take over the day-to-day management of the New Zealand company's centres.

Peppercorn has been reported as saying the deal means a management fee of $2000 a month for each centre plus a performance fee of 9 per cent of Kidicorp's ebitda or an average of $35,000 a year in revenue per centre.

Wright says that isn't quite correct. In the first year, Peppercorn's management fee will equal the amount Kidicorp had budgeted to run the centres itself. In addition, Peppercorn can earn up to 9 per cent of ebitda if profitability is in excess of what Kidicorp could make on its own, he says.

"It should be cashflow and cost neutral to Kidicorp. We're outsourcing the most frustrating part of the business, the day-to-day management. So we can focus on growing the company."

He aims to double the company's size by the end of next year.

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