Commercial Child Care in Canada
CAN CHILD CARE THRIVE IN A SPECULATIVE INVESTMENT ENVIRONMENT?

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Acknowledgements

We have prepared this report on the direction of the Coalition of Child Care Advocates of BC. We would like to thank them for giving us this opportunity to take an in depth look at the financial underpinnings of commercial child care as it is newly emerging in Canada. This report is a starting point for understanding the potential implications of this form of child care provision in the Canadian context.

Forward

Although a number of commercial child care chains are emerging in Canada it has only been since May of 2010 [1] that Canada has had a publicly traded company, with the primary objective of delivering child care services, listed on the TSX. Other countries have had publicly traded child care companies for a number of years. Most notably, publicly traded commercial child care chains exist in the USA, Britain and Australia.

In fact, Australia provides an example of a recent, aggressive and dramatic experiment [2] with a publicly traded commercial child care chain. Before the Australian company ABC Learning Inc. collapsed under the weight of its self-created financial excess in November 2008, the company managed to capture and control approximately 25% of the licensed child care spaces in that country. [3] The sudden collapse of ABC Learning Inc. had the potential of creating a politically unacceptable void for child care services in Australia. This forced the Australian Government to put up millions of dollars to keep the company running while the Receivers worked out an agreement with a coalition of non-profit societies to take over the operations. [4] The Australian Government was then compelled to put up the majority of the funding (via long-term repayable loans) to allow the non-profit society group to acquire the ABC Learning Inc. assets at a very small fraction of their original book value.

One of the incentives for a public company to enter the child care market is access to public funding, frequently through government operating grants paid directly to the services and/or through parent fee subsidies and tax credits. [2]

The Australian government, much like the Canadian governments, has offered a variety of methods of subsidising the cost of licensed child care. In 1991, the Australian government changed the rules to make parent fee subsidies, which had previously been available only to those using non-profit centres, available to Australian families using commercial centres. In 1996 operational subsidies for non-profit care were abolished and by 2000 the reorientation of subsidies from supply-side to demand-side was complete. With a player in the market as aggressive and dominant as ABC Learning Inc. there was little to stop the company from raising fees and in the interest of trying to keep child care affordable government increased parent subsidies. By 2005, the last good year before the collapse, ABC Learning Inc. was deriving 44% of its revenue from government, a whopping $128 million. The publicly traded company now providing child care in Canada shares many of the same operating characteristics as ABC Learning Inc. Whether it is likely to share a similar fate as ABC Learning is a key question.

Methodology

This report has been prepared based on public information from government, a publicly traded child care company, child care organisations, public media and from information obtained by direct inquiry. We have also used our knowledge and experience as public accountants working with the child care sector in British Columbia for the past 30 years. This report has used the published information noted above as its primary sources. We have considered the information acquired from government and corporate sources as valid and true based on the vetting and verification procedures that are known to exist related to the preparation of publicly issued documents from these sources. We have endeavoured, whenever possible to obtain objective third party verification for information coming from child care advocacy organisations and the public media. For the most part the information from these sources has been used to provide direction or exposure of issues and not as supporting fact on which this report is based.

A significant portion of this report is dedicated to financial analysis and the preparation of projections used to support the information used in the report. The reader is cautioned that any projections or future oriented information provided in this report is prepared solely for the purpose of determining the range of potential outcomes for discussion purposes and is not intended to be used as a forecast of future operations for any corporation(s) on which the information is based. The information in this report is wholly and totally unsuitable to be used for the purposes of determining the future value of investments in the subject corporations.

Purpose

The main purpose of this report is to analyze the viability and sustainability of the existing Canadian model of a publicly traded company operating a chain of child care centres . Viability and sustainability refer not only to the company being reviewed but to the child care environment as a whole. In addition, the report considers the potential implications of these findings for those interested in the broader question of how to expand access to child care services in Canada.

Can Child Care Thrive in a Speculative Market?

To answer the question we have used the only Canadian example of a publicly traded company working exclusively in the area of providing child care services. The name of this corporation is Edleun Group, Inc. The company trades on the TSX Venture Exchange under the symbol "EDU-X". [(1)] Edleun commenced operations in May of 2010 and is in the early development stage of operations. The company operates primarily in Alberta, and has made a recent entry into British Columbia and, in late 2011, into Ontario. Most of the efforts of the company to date have been directed toward raising funds, acquisitions of child care centres, branding, and policy/systems development.

The Edleun acquisitions have favoured the purchase of existing centres over new builds. This has allowed the company to amass a considerable number of functional child care spaces in a very short period of time. The company is currently in the process of constructing its first new purpose built child care facilities and has stated that these facilities will be used as a model for future new build centres as it executes its strategic plan. [(5)]

One of the benefits of looking at a publicly traded company is the quantity of information that is readily available through the public reporting process. The public company reporting requirements have served us well. However, this does not mean that the information required is available or that the information is consistent between sources or complete. Unfortunately, there are several key pieces of information that are highly relevant to child care operations that are not readily available. There are also a few instances where information is contradictory or not comparable between different sources within the Edleun system. A primary example of this problem is the reporting of the number of operating centres and child care spaces. In some publications all centres/spaces are counted including centres where the acquisition is not yet complete. In other publications only the centres and spaces under current Edleun-controlled operations are counted. This inconsistency caused problems in the analysis of calculations such as the cost per child care space, staffing requirements and public subsidy calculations. We have noted in our analysis which information we have used as the basis for our calculations where there was conflicting information available.

A Suggested Edleun Operating Model

Despite extensive research we were not able to find a forecast or model prepared by Edleun for what the company would look like in its fully operational state. According to Globe and Mail "Vox" writer David Milstead in his February 8, 2012 column in The Globe and Mail [(6)], there is a model that was prepared by Jeffrey Roberts in his role as analyst for Desjardins Securities. Shortly after recommending Edleun as a "Buy" with a target value of $1.75 per share Mr. Roberts joined Vision Capital (Edleun's largest shareholder) as Senior Vice President and Assistant Portfolio Manager. This Buy rating valued Edleun at just over $200 million on the stock market. As we can show, Mr. Roberts is a very optimistic man.

The Roberts model presented to support the Edleun contention that significant profits can be made operating a chain of child care centres across Canada is a classic "buy low, sell high" scenario. As most

investors know, the strategy is easy to say and very difficult to execute. The Roberts model, as described by Mr. Milstead, is simple in design and this simplicity is its downfall. [6] The model is summarized as follows:

1. Purchase an operating 6,500 sq. ft. child care centre licensed for 100 children for $1.16 million, including land and buildings. Allocate $800,000 of the purchase price to the real estate and the remaining $360,000 of the purchase price to the business (child care operations). The price for the business assumes that the child care centre can generate $200,000 per year EBITA on total revenue of $662,000 despite operating at only 80% occupancy.
2. Apply $200,000 worth of upgrades to the building to improve the look and brand the centre as an Edleun operation.
3. Increase the occupancy from 80% to 95% and increase the parent fees by 5%.

Those three simple steps, according to Mr. Roberts, will increase the value of the real estate by $0.5 million ($0.2 million for the cost of improvements and $0.3 million for the resulting increase in rentable value of the centre) and the value of the business by $1.17 million. In total, Mr. Roberts projects that within a 12 month period the combined value of the child care centre's business and real estate will increase by 144% to $2.83 million ($1.16 million original investment plus $0.20 million building upgrades plus $0.30 million increase in rentable value plus $1.17 million increase in business operations value). Here are some issues with this simple strategy:

1. A child care centre licensed for 100 children operating at 80% occupancy is highly unlikely to generate $200,000 per year EBITA. As shown in the model for a child care centre licensed for 100 children (see Schedule 1) that we have prepared using our extensive database of Child Care Centre operating statements, an 80% occupancy level is at best a breakeven at the EBITA level of net income. A cost efficient child care centre of the size quoted, operating at 100% capacity, will make about 2/3 of the EBITA income that Mr. Roberts model assumes for an 80% capacity centre. This is a key consideration because, if a centre is already at capacity there is no room for the type of margin improvement that Mr. Roberts suggests is possible. Also, according to Mr. Robert's speculations, child care centres would need to be among the most profitable of small enterprises to make his projections come true. This is simply not the case from our experience. The long term gap between child care space demand and supply would never have existed if child care centre operations were as profitable as Mr. Roberts implies in his analysis.
2. The types of improvements to the land and building that are entailed in the $200,000 expenditure are cosmetic at best. They include such items as paint, minor repairs and basic maintenance, refresh of play areas and branding. None of these items provide justification for assuming an increase in resale value of the property. The Roberts model has the company increasing the property value by $500,000, an optimistic assumption. The assumption, even if not as optimistic, is irrelevant. The company is not in the

business of selling real estate (or child care centres for that matter) for resale. Edleun is in the business of operating child care centres. Child care is and always will be a bricks and mortar business with land and buildings an essential part of the equation. Unless the child care centre ceases to operate, and also ceases to generate cash flow for the business, land and buildings can only be traded and not sold, creating no net gain for the shareholders.

3. We can agree with Mr. Roberts on one point: raising parent fees will generate more revenue and make the business more valuable, assuming that enough parents are willing and able to pay the increased fees. However, given our comments in point 1 above, the likely value creation is not even remotely as great as Mr. Roberts model indicates. The model suggests Edleun pays $360,000 initially for the business operations of the child care centre, which is a multiple of 3 times the estimated earnings ($200,000 EBITA earnings less an $80,000 implied rent equals $120,000 earnings, multiplied by three equals $360,000). After the building upgrades and parent fee increases, the model projects that the earnings would increase to $165,000 ($265,000 EBITA less implied rent, which has increased to $100,000). Based on what they were willing to pay for the business that would imply a business value increase to $495,000 ($165,000 multiplied by three). Mr. Robert's model, however, suggests that the business value would increase to $1.53 million ($360,000 original investment plus $1.17 million business operations value increase). Somehow an extra $1.04 million gets created out of nowhere ($1.53 million less implied increased business value of $495,000).

Based on our reasoning and analysis it is highly unlikely that the scenario that Mr. Roberts has outlined could ever exist.

At any rate, up to the end of 2011 it does not appear as if Edleun has been able to find any acquisitions as outlined by Mr. Roberts. The average price paid per space in the Roberts model is $13,600, while the actual average price per space paid by Edleun has been $15,500 including upgrades. Based on the 3,660 spaces that Edleun has purchased to date this difference has increased acquisition costs by an additional $6.95 million or 12.25%. The Roberts model also implies a mix of 70% real estate and 30% business value in the purchase price. To date, Edleun's acquisition mix has been 40% real estate, 20% business assets and 40% surplus to book value (Goodwill). Given that Goodwill is generally not a saleable commodity, it is clear that the value of the acquisitions is substantially less than projected in the Roberts model and, in the event that disposal of any of the centres becomes necessary, substantial losses are likely to be incurred. It is interesting to note that this is the same situation that ABC Learning Inc. found itself caught in shortly before its demise. [(2)]

Furthermore, actual occupancy levels at most of the centres Edleun has acquired thus far have been well above the targeted 80% level (except for some centres purchased during the summer when enrollment can be seasonally low) and therefore the earnings gains are much lower than anticipated. Also, the majority of the centres acquired are in leased premises, so the real estate portion of the projected gains are not applicable in the majority of the acquisitions.

Not only is the Roberts model unlikely to occur but Edleun has not pursued the suggested strategy with the vigor that one would expect with such a sure and simple recipe for making large sums of money.

The Apparent Edleun Operating Model – based on actual operations

As at the end of December 2011 Edleun has gained control of 3,660 child care spaces in Alberta, British Columbia and Ontario. [7] It is interesting to note that not one of these spaces provides new capacity. There are a couple of new build projects on the books but they will not make up more than 10% of the total spaces under current control. From the strategic information published by Edleun it is apparent that this practice of purchasing existing centres will continue for some time into the future. It appears as though Edleun will be but a minor player in the critical need for the provision of additional child care capacity in Canada. [5]

It is also apparent from the financial statements issued by Edleun that the company has much work to do before the shareholders will see anything like an actual return on their investment. One indication of this assertion is the fact that, since it began operating in May of 2010 [7], the company has accumulated $5.17 million in losses.

More importantly, however, the current market pricing ($0.89/share Dec 29, 2011) and the Edleun Audit report for 2011 (116,005,319 shares outstanding) indicate that the company has a market value of $103.71 million, 78% higher than the company's book value of $58.28 million.

The market value of Edleun is based in large part on speculation. Only 16 months into active operations, the market is placing a premium of 78% on the company's book value. This premium rises to 196% when the value of the Intangible Assets (value paid for assets in excess of market value) is discounted [Market Value $103.71 /(Book Value $58.28 – Intangibles $23.28) [7]]. It is a tested and proven strategy to pay a premium on the value of something if you believe that it will be worth much more than you paid for it at some foreseeable point in the future. Such an approach may be high risk but it makes sense if you have good reason for your optimism. We can apply a simple test to the Edleun valuation, as outlined in the following section, to determine whether the optimism is warranted or not.

Viability in a Status Quo scenario

The Overhead costs of Edleun are currently running at $7.2 million per year (after removal of the acquisition costs). The Operating margin as defined by Edleun is running at around 30% for each child care centre. A minimum acceptable return on market value for a company with the risk profile of Edleun is a Price/Earnings ratio of 17 or roughly a 6% return on market value. So, 6% of the $103.71 million market value is $6.1 million. This is the level of net earnings (after all costs, including overhead, taxes, interest, etc.) that the market is anticipating Edleun will be able to make with its current level of investment. Working this backwards it is possible to calculate what kind of revenue level is needed to support this earnings level. Using the Overhead cost and Operating margin information above, the calculation yields a revenue requirement of $41.1 million per year. (see Schedule 2)

Schedule 2 provides the details of this calculation. To summarize, we estimate that Edleun is currently generating an average gross revenue of $7,683 per child care space annually based on our estimated

average of 2,366 revenue-generating child care spaces in 2011. Next, we've generously assumed that it would be possible to expand revenue without incurring additional Overhead costs. Thus, to generate $41.1 million of revenue per year at the current average gross revenue of $7,683 per space, Edleun requires 5,350 spaces in total. Currently the company has 3,660 spaces (an average of only 2,366 spaces were available for the full year in 2011). To meet the minimum market expectations Edleun needs to increase its child care spaces by 46% without buying or building any additional child care centres. That can't happen because the existing centres are already near maximum capacity, so a significant increase in revenue can't be attained without a direct increase in the number of child care spaces and the number of child care spaces can't be materially affected without additional land and buildings.

The above-noted problem of achieving anticipated earnings levels raises questions about why, to date, the market has been willing to pay a substantial premium on Edleun's book value. This premium is normally attributable to the ability of the company to exploit currently untapped revenue sources in their market place. In a traditional sales or service based company growing revenue is straightforward: sell more or sell for more. The traditional revenue stream is elastic because you can add more products or services or add more customers or both. However, it appears that investors do not understand that this luxury does not exist in child care centres, or rather it does not exist without additional capital outlays to build more capacity. Child care centre revenue is constrained by regulation on the capacity side and constrained by both the number and income levels of parents on the pricing side.

In other words, child care does not fit a traditional business revenue generation model.

A child care centre has limited capacity to grow revenue because of licensing regulations. Staff-to-child ratios and space-per-child ratios, which support children's health and safety, are significant barriers to materially increasing the child population and the attending revenues. This leaves fee increases as one of only two means of increasing revenue without incurring significant additional capital costs. The other means of increasing revenue is through increased government subsidies.

Yet, dramatic increases in one or both of these options would be required in order to meet minimum stock market expectations at this point in time. Specifically, we estimate that the current revenue per space of $7,683 (Annual revenue / 2,366 equivalent full-time revenue generating spaces in 2011) annually would have to increase by 46% to $11,233 (based on the full 3,660 spaces owned at the end of 2011) in order to generate total revenue of $41.1 million (the amount needed to meet market expectation based on the market price of the stock, see Schedule 2). If the economics result in an increase in parent fees and/or public subsidies from government it would put Canada a step closer to the cautionary tale of Australia. The impact on the Australian purse of moving to demand side subsidies has been phenomenal. Between 1990 and 2004, federal funding for child care grew from $200 million a year to $1.5 billion, increasing at an annual rate of 14.4 per cent, or four times the annual economic growth rate. This trend continued. Funding more than doubled between 2004/05 and 2008/09 from $1.7 billion to $3.7 billion in 2008-09 and is expected to further increase to $4.4 billion in 2012-13. [8]

Viability in an Aggressive Expansion Scenario

The other strategy open to the company is to keep buying up existing capacity until the economic picture lines up correctly. Currently Edleun is paying $15,500 per upgraded child care space. Assuming that Edleun could keep its Overheads at no more than $15 million (currently they are running at $7.2 million) and its self-defined child care centre Operating Margin at 30% of Revenue, we can project the business model that would be required to support a market valuation equal to 150% of book value (the premium to book value is currently 196% with Intangible assets removed from the equation, see Schedule 2 and Schedule 3). The purpose of this exercise is to discover how many child care spaces must be owned by Edleun in order to make their scheme viable. Viability is far more difficult to achieve with a public corporate model than a private corporate model because the public model requires a return on the "speculative value" of the shares in addition to the simple book value return used in a private corporate model.

Even with our optimistic assumptions on Operating Margin and Overhead costs there is one more highly optimistic assumption built into our analysis. That is, that the company will be profit neutral during the build-up period that will be required in order to get to the target level of child care spaces, so that additional capital is not required to support accumulated operating losses. This is an optimistic assumption, given that over $5 million in losses were incurred in the 20 months of operations ending December 31, 2011.

Taking all of the above assumptions into account Edleun would be required to have under its control 26,000 child care spaces (see Schedule 2) in order to meet current market expectations. Total revenue would be $200.0 million and Edleun would also need to have generated pre-tax profit at the rate of 23% of total revenue ($46 million). Of the $200.0 million in revenue 20% of that amount, or $40.0 million (based on the current subsidy usage shown in Schedule 3), is assumed to come from government subsidy. To gain a perspective on just how important government subsidy is to corporate viability, 87% of the profit that would, under these assumptions, support the return in the marketplace would come from government funding which is presumably designed to promote quality child care that is affordable for parents.

At the projected level of operation that we have identified above, Edleun would have had to raise a total of $400 million from the marketplace (Edleun has currently raised $63 million [7]) in order to finance its expansion, resulting in a market valuation of $600 million.

Conclusions

This report illustrates the reality for commercial child care chains, whether a publicly traded company, as in this analysis, or another form of business ownership. One conclusion is that the typical strategies used to achieve viability and provide a return for investors, shareholders and owners do not easily apply to the 'business' of caring for young children. Child care does not fit a classic business revenue generation model.

The conventional approach to increasing revenue is to add more products or services. However in child care, growing the number of fee paying children/parents (revenue) must be accompanied by an expansion of the physical premises (capital expense) and the cost of increasing human resources (the largest component of operating expenses). In other words, materially increasing the revenues related to child population may only occur if accompanied by revenue depleting capital and human resource costs.

Child care centre revenue is constrained by regulation on the capacity side and by both the number and income levels of parents on the pricing side. An individual child care centre has limited capacity to grow revenue due to licensing regulations which dictate staff-to-child and space per child ratios. These minimum standards are in place to protect children's health and safety. Traditional economies of scale, the cost advantages that an enterprise obtains due to expansion, do not apply with respect the delivery of child care services. Therefore, rather than adding more capacity to existing facilities, companies must increase child care spaces (i.e. grow the business) through the acquisition of more facilities.

Our analysis demonstrates that the current strategy of the only publicly traded company in Canada requires a very large number of child care spaces (and therefore many facilities) to be under their control in order for the company to reach viability. Development of this new child care capacity tends to be expensive, slow and time consuming so the company's approach is to "pick the low-hanging fruit" (buying up capacity from operators nearing retirement or centres in distress). In a publicly traded marketplace where there is a premium on keeping the market stimulated and investors happy, Edleun may find themselves forced to continue operating in this manner. At the current rate of development the analysis in this report suggests that the company will need to make several more trips to the market to raise funds to cover both future growth and past losses, with each trip progressively more difficult to sell.

While the primary financial risks associated with commercial child care chains are squarely on the shoulders of owners and investors (including shareholders of publicly traded companies), to avoid failure there is also a risk for government and for the users of child care. That's because the only alternative to increasing capacity is to extract as much revenue as possible from parent fees and government subsidy. Our analysis suggests that a dramatic increase in one or both of these options would be required in order to meet minimum stock market expectations for our sample company at this point in time. But is this appropriate or even possible?

With respect to parent fees, the amount of money that families with young children have to spend on child care is finite and the cost of child care is already prohibitive for many. With respect to government subsidies a question must be posed. Should the public purse contribute to private gain?

Although not covered in our report there are other factors about the efficacy of commercial child care that should be under scrutiny. The development of child care capacity is a significant imperative for Canadian society yet this company's focus thus far has been acquiring existing facilities rather than building new ones. Other commercial child care chains focus on developing services for specific niches rather than for the public at large. And, because a market reality for a publicly traded company is to maximize the return on investment there is a disincentive for expenditure on costs like wages, benefits and facility maintenance while retention of well-qualified staff is often minimized. This is in conflict with the pursuit of quality environments for young children.

Can child care thrive in a speculative investment environment? Based on an analysis of the public documents available for the only publicly traded commercial child care chain in Canada, this report concludes that the answer to this question is "not likely". Perhaps this finding should not be a surprise. After all, if it was that easy to profit by building quality child care services that most parents can afford, there wouldn't be just one publicly-traded commercial child care chain in Canada.

Schedules

Schedule 1 – Child Care Operating Model – 100 space Centre (based on centres operated in BC)

Child Care Centre

STATEMENT OF OPERATIONS - CONSOLIDATED

For The Year Ending December 31, 2011 — **Unaudited - See Notice to Reader**

	100% Occupancy $	% of Revenue $	95% Occupancy $	% of Revenue $	80% Occupancy $	% of Revenue $
Revenues:						
Parent Fees (incl. parent subsidy)	**988,000**	84.1%	**938,600**	84.0%	**790,400**	83.9%
Government Operating Grants	**175,000**	14.9%	**166,250**	14.9%	**140,000**	14.9%
Other Income	**12,000**	1.0%	**12,000**	1.1%	**12,000**	1.3%
Total Revenues	$ **1,175,000**	100.0%	$ **1,116,850**	100.0%	$ **942,400**	100.0%
Operating Expenses:						
Employment Expenses	**926,000**	78.8%	**926,000**	82.9%	**833,400**	88.4%
Repairs, Janitorial & Utilities	**32,000**	2.7%	**32,000**	2.9%	**32,000**	3.4%
Office Administration	**28,000**	2.4%	**28,000**	2.5%	**28,000**	3.0%
Program Expenses (Toys & Food)	**26,000**	2.2%	**26,000**	2.3%	**21,000**	2.2%
Accounting	**16,000**	1.4%	**16,000**	1.4%	**16,000**	1.7%
Insurance	**6,000**	0.5%	**6,000**	0.5%	**6,000**	0.6%
Other Expenses	**7,000**	0.6%	**7,000**	0.6%	**7,000**	0.7%
Total Expenses	$ **1,041,000**	88.6%	$ **1,041,000**	93.2%	$ **943,400**	100.1%
EBITA	$ **134,000**	11.4%	$ **75,850**	6.8%	$ **(1,000)**	-0.1%
Financial Expenses						
Rent	**72,000**	6.1%	**72,000**	6.4%	**72,000**	7.6%
Amortisation	**9,000**	0.8%	**9,000**	0.8%	**9,000**	1.0%
Interest	**3,000**	0.3%	**3,000**	0.3%	**3,000**	0.3%
Income tax	**11,000**	0.9%	**(2,000)**	-0.2%	**(18,000)**	-1.9%
Total	$ **95,000**	8.1%	$ **82,000**	7.3%	$ **66,000**	7.0%
Net Earnings	$ **39,000**	3.3%	$ **(6,150)**	-0.6%	$ **(67,000)**	-7.1%

Schedule 2 – Capitalisation Analysis

Edleun Group Inc. - Edleun Learning Centres

Pro Forma Capital Requirements Analysis

		2011		2010	
Property & Equipment	$	33,434,000	$	18,716,969	FS - Balance Sheet
Goodwill		22,940,000		9,182,598	FS - Balance Sheet
Amortisable Intangibles		340,000		-	FS - Balance Sheet
	$	56,714,000	$	27,899,567	
Owned Childcare Spaces		3,660		1,806	Year end total
Capital Cost per Space	$	15,496	$	15,448	
Revenue Generating Space		2,366		1,806	Year end avg revenue generating
Revenue per childcare space	$	7,683	$	7,576	
Capital Requirement to support earnings demand based on Capital Employed					
Total Capital Employed		58,281,000		36,128,442	FS - Balance Sheet
Implied Earnings		**3,885,400**		**2,408,563**	15x multiple
Revenue required	$	41,114,167	$	34,202,345	current Fixed overhead @ 30% margin
Childcare spaces required		5,352		4,515	
Capital cost of required spaces	$	82,926,478	$	69,741,465	
Additional Capital Required	**$**	**49,492,478**	**$**	**41,841,898**	
Capital Requirement to support earning demand based on Market Valuation					
Share Price	$	0.89	$	0.85	Dec 31 pricing
Outstanding Shares		116,530,319		115,404,901	FS - Notes
Total Market Valuation	$	103,711,984	$	98,094,166	
Implied earnings		**6,100,705**		**5,770,245**	15x multiple
Revenue required	$	50,344,604	$	48,209,354	current Fixed overhead @ 30% margin
Childcare spaces required		6,553		6,363	
Capital cost of required spaces	$	101,544,091	$	98,302,938	
Additional Capital Required	**$**	**43,263,091**	**$**	**62,174,496**	

Capital and Child Care space requriement to generate earnings to support the Market Valuation			
Market Valuation Target		**150%**	Multiple of book value
Earnings to support Valuation	$	200,000,000	
Operating Margin		30%	
Overhead Costs	$	15,000,000	
Corporate Tax Rate		22%	
After tax earnings	$	35,100,000	
After tax Return on Capital		9%	
After tax Return on Valuation		6%	
Pre Tax Profit Percentage		23%	
Child Care spaces Required		**26,033**	
Capital Cost of Requried Spaces	$	403,396,125	
Market Valuation based on target	$	605,094,188	

Schedule 3 – Edleun Financial Model (based on Alberta centre operating data)

Edleun Group Inc. - Edleun Learning Centres
Pro Forma Statement of Operations

	2011 Actual		Model		Reference
Fee revenue			$ 13,682,400	**81%**	see Schedule - Fee Revenue
Wage Subsidies			$ 3,056,344	**18%**	see Schedule - Staffing
Quality/Infant Grants			$ 252,600	**1%**	see Schedule - Fee Revenue
	$ 18,177,000		**$ 16,991,344**		
Salaries, Wage & Benefits	$ 9,107,000	**50.1%**	$ 9,192,221	**54.1%**	see Schedule - Staffing
Other Operating	3,343,000	**18.4%**	2,517,600	**18.4%**	% of Revenue per FS 2011
	5,727,000	**31.5%**	**5,281,523**	**31.1%**	
General & administrative	$ 4,642,000	**25.5%**	$ 4,200,000	**24.7%**	
Premises Operating	-	**0.0%**	400,000	**2.4%**	50% of Lease cost
Stock based compensatio	434,000	**2.4%**	400,000	**2.4%**	per FS 2011
Premises Lease	906,000	**5.0%**	800,000	**4.7%**	from FS 2011 Note 8
	5,982,000		5,800,000	**34.1%**	
Net Operating Loss	**-$ 255,000**		**-$ 518,477**	**-3.1%**	
Amortisation	1,058,000		1,069,500		from FS 2011 Note 5
Acquisition costs	1,330,000		1,300,000		per FS 2011 Stmt of Operations
Comprehensive Net Loss	**-$ 2,643,000**		**-$ 2,887,977**		
Other Income	**$ 251,000**		**$ -**		
Deferred Tax	**$ 8,000**		**$ -**		
Total Net Loss	- 2,400,000		- 2,887,977		

Amortisation Detail		Years		
Land	5,657,000	N/A	-	from FS Note 4
Buildings	17,545,000	30	584,800	from FS Note 5
FF&E	2,334,000	8	291,750	from FS Note 5
Other Equipment	435,000	4	108,750	from FS Note 5
Goodwill - amortised	421,000	5	84,200	from FS Note 5
			1,069,500	
Goodwill - unamortised	22,940,000	N/A		from FS Note 5
Assets not in Use	8,746,000			from FS Note 5

Schedule 4 – Fee Revenue Model

Edleun Group Inc. - Edleun Learning Centres
Pro Forma Fee Revenue Forecast

Name	City	Nursery	Infant	Toddler	P-S	K-G	OoS	Total Revenue	Vacancy Rate	Vacancy Loss	Net Revenue
Acadia	Calgary	6,600	7,000	28,800	18,400	-	-	60,800	9.8%	6,000	54,800
Bermuda	Calgary	6,600	9,000	19,200	35,200	-	4,800	74,800	9.8%	7,300	67,500
Bowness	Calgary	-	-	21,600	28,800	-	11,200	61,600	9.8%	6,000	55,600
Deer Ridge	Calgary	11,000	8,000	28,800	16,800	14,400	8,400	87,400	9.8%	8,600	78,800
Falconridge	Calgary	-	-	16,000	33,600	-	7,200	56,800	9.8%	5,600	51,200
Falsby Way	Calgary	-	8,000	8,800	12,800	13,600	-	43,200	9.8%	4,200	39,000
Marlborough	Calgary	-	18,000	14,400	32,000	17,600	9,200	91,200	9.8%	8,900	82,300
Ranchlands	Calgary	6,600	8,000	17,600	12,000	16,800	-	61,000	9.8%	6,000	55,000
Rundle	Calgary	3,300	4,000	19,200	39,200	-	5,600	71,300	9.8%	7,000	64,300
Southwood East	Calgary	6,600	12,000	32,000	16,000	-	-	66,600	9.8%	6,500	60,100
Southwood	Calgary	-	-	9,600	8,000	16,000	-	33,600	9.8%	3,300	30,300
Whitehorn	Calgary	-	8,000	19,200	12,800	13,600	6,000	59,600	9.8%	5,800	53,800
Woodlands	Calgary	3,300	5,000	9,600	17,600	17,600	12,000	65,100	9.8%	6,400	58,700
Hermitage	Edmonton	5,500	12,000	22,400	12,800	16,000	28,800	97,500	25.3%	24,700	72,800
Millwoods	Edmonton	-	18,000	22,400	11,200	24,800	8,000	84,400	25.3%	21,400	63,000
Sherwood Park	Sherwood Park	-	-	14,400	25,600	24,000	46,800	110,800	25.3%	28,000	82,800
Leduc	Leduc	13,200	5,000	9,600	24,800	16,000	9,600	78,200	25.3%	19,800	58,400
Eastview	Red Deer	-	12,000	9,600	12,800	13,600	-	48,000	14.1%	6,800	41,200
Oriole Park	Red Deer	-	8,000	8,000	12,800	16,000	-	44,800	14.1%	6,300	38,500
Riverside Meadows	Red Deer	-	7,000	9,600	9,600	11,200	-	37,400	14.1%	5,300	32,100
		62,700	149,000	340,800	392,800	231,200	157,600	1,334,100	15%	193,900	1,140,200

Annual	
Maximum Revenue	16,009,200
Vacancy Loss	2,326,800
Net Revenue	13,682,400

Infant Subsidy Rate	$	150	Month
Infant Subsidy	$	102,600	Year

Quality Funding Grant	$	150,000

Schedule 5 – Staffing Model – Staffing Grid

Edleun Group Inc. - Edleun Learning Centres

Pro Forma Staffing Requirements/Cost/Subsidy

		Minimum Staffing per Census						Minimum	Overlap	Total	
Name	City	Nursery	Infant	Toddler	P-S	K-G	OoS	Total	Staff	Staff	Directors
Acadia	Calgary	2.00	1.75	6.00	2.88	0.00	0.00	12.63	2.53	15.16	1
Bermuda	Calgary	2.00	2.25	4.00	5.50	0.00	0.80	14.55	2.91	17.46	1
Bowness	Calgary	0.00	0	4.50	4.50	0.00	1.87	10.87	2.17	13.04	1
Deer Ridge	Calgary	3.33	2	6.00	2.63	1.80	1.40	17.16	3.43	20.59	1
Falconridge	Calgary	0.00	0	3.33	5.25	0.00	1.20	9.78	1.96	11.74	1
Falsby Way	Calgary	0.00	2	1.83	2.00	1.70	0.00	7.53	1.51	9.04	1
Marlborough	Calgary	0.00	4.5	3.00	5.00	2.20	1.53	16.23	3.25	19.48	1
Ranchlands	Calgary	2.00	2	3.67	1.88	2.10	0.00	11.65	2.33	13.98	1
Rundle	Calgary	1.00	1	4.00	6.13	0.00	0.93	13.06	2.61	15.67	1
Southwood East	Calgary	2.00	3	6.67	2.50	0.00	0.00	14.17	2.83	17.00	1
Southwood	Calgary	0.00	0	2.00	1.25	2.00	0.00	5.25	1.05	6.30	1
Whitehorn	Calgary	0.00	2	4.00	2.00	1.70	1.00	10.7	2.14	12.84	1
Woodlands	Calgary	1.00	1.25	2.00	2.75	2.20	2.00	11.2	2.24	13.44	1
Hermitage	Edmonton	1.67	3	4.67	2.00	2.00	4.80	18.14	3.63	21.77	1
Millwoods	Edmonton	0.00	4.5	4.67	1.75	3.10	1.33	15.35	3.07	18.42	1
Sherwood Park	Sherwood Park	0.00	0	3.00	4.00	3.00	7.80	17.8	3.56	21.36	1
Leduc	Leduc	4.00	1.25	2.00	3.88	2.00	1.60	14.73	2.95	17.68	1
Eastview	Red Deer	0.00	3	2.00	2.00	1.70	0.00	8.7	1.74	10.44	1
Oriole Park	Red Deer	0.00	2	1.67	2.00	2.00	0.00	7.67	1.53	9.20	1
Riverside Meadows	Red Deer	0.00	1.75	2.00	1.50	1.40	0.00	6.65	1.33	7.98	1
		19.00	37.25	71.01	61.40	28.90	26.26	243.82	48.77	292.59	20.00

Schedule 5 – Staffing Model – Wage Grid

Edleun Group Inc. - Edleun Learning Centres
Pro Forma Staffing Requirements/Cost/Subsidy

	Wage Payment Details				Subsidy Details				
	Rate/Hr	Rate/Day	Rate/Mo	Annual	Level	Rate/Hr	Rate/Day	Rate/Mo	Annual
Avg Care Wage	$ 13.00	$ 104	$ 2,167	$ 26,000	2	4.05	$ 32	$ 675	$ 8,100
Avg Director Wage	$ 15.00	$ 120	$ 2,500	$ 30,000	3	6.62	$ 53	$ 1,103	$ 13,240

Avg Benefit rate: 12%
Overlap Staff ratio: 1 FTE each 5 staff

Care Wage & Ben	8,520,221
Director Wage & Ben	672,000
Total Direct Wages	**9,192,221**

Wage Subsidy	$ 2,634,779
Benefit Contribution	$ 421,565
	$ 3,056,344

Schedule 6 – Child Ratios and Child Care Rates

Edleun Group Inc. - Edleun Learning Centres
Pro Forma Ratios and Fee Rates

AB	Nursery 0-12mo	Infant 12-19mo	Toddler 19-36mo	P-S 36-54mo	K-G 54-60mo	OoS 6-12yr
Group	6	8	12	16	20	30
Ratio	3	4	6	8	10	15
Rate	$ 1,100	$ 1,000	$ 800	$ 800	$ 800	$ 400

BC	Inf/Toddler 0-36mo	Daycare 30-60mo	Preschool 30-60mo	OoS 5-12yr	OoS 7-12yr
Group	12	25	20	24	30
Ratio	4	8	10	12	15
Rate	$ 1,100	$ 800	$ 800	$ 500	$ 500

Schedule 7 – Centre Census by Program

Edleun Group Inc. - Edleun Learning Centres
Pro Froma Childcare Licensing Census

Name	City	Nursery	Infant	Toddler	Preschool	K-garten	OoS	Licensing Total	Web total
Acadia	Calgary	6	7	36	23	0	0	72	71
Bermuda	Calgary	6	9	24	44	0	12	95	85
Bowness	Calgary	0	0	27	36	0	28	91	92
Deer Ridge	Calgary	10	8	36	21	18	21	114	114
Falconridge	Calgary	0	0	20	42	0	18	80	104
Falsby Way	Calgary	0	8	11	16	17	0	52	52
Marlborough	Calgary	0	18	18	40	22	23	121	103
Ranchlands	Calgary	6	8	22	15	21	0	72	72
Rundle	Calgary	3	4	24	49	0	14	94	94
Southwood East	Calgary	6	12	40	20	0	0	78	80
Southwood	Calgary	0	0	12	10	20	0	42	80
Whitehorn	Calgary	0	8	24	16	17	15	80	80
Woodlands	Calgary	3	5	12	22	22	30	94	114
Hermitage	Edmonton	5	12	28	16	20	72	153	152
Millwoods	Edmonton	0	18	28	14	31	20	111	112
Sherwood Park	Sherwood Park	0	0	18	32	30	117	197	197
Leduc	Leduc	12	5	12	31	20	24	104	104
Eastview	Red Deer	0	12	12	16	17	0	57	57
Oriole Park	Red Deer	0	8	10	16	20	0	54	54
Riverside Meadows	Red Deer	0	7	12	12	14	0	45	45
		57	149	426	491	289	394	1806	1862

Schedule 8 – Centres Used in Model Development

Edleun Group Inc. - Edleun Learning Centres
List of Operating Centres Used in Model Development

Name	Address	City	Code	Prov	Director
Acadia	236 Acadia Dr	Calgary	T2J 0A5	AB	H McKenzie
Bermuda	3 Bermuda Rd	Calgary	T3K 1G5	AB	L Herbert
Bowness	3711 73rd St	Calgary	T3B 2L6	AB	M Calvert
Deer Ridge	116 Deerview DR SE	Calgary	T2J 6C9	AB	T Letondre-Chan
Falconridge	80 Falshire Dr	Calgary	T3J 1A4	AB	E Lau
Falsby Way	116 Falsby Way NE	Calgary	T3J 1C4	AB	J Johnson
Marlborough	4603 Marbank Dr NE	Calgary	T2A 3V8	AB	D Kondracki
Ranchlands	1829 Ranchlands Blvd NW	Calgary	T3G 2A7	AB	M Zaprzelski
Rundle	3802 Rundlehorn Dr NE	Calgary	T1Y 2K1	AB	C Pawlyshyn
Southwood East	10620 Sacremento Dr SW	Calgary	T2W 1S5	AB	T Davis
Southwood	10807 Elbox Dr SW	Calgary	T2W 1G5	AB	I Kessel
Whitehorn	3704 Whitehorn Dr NE	Calgary	T1Y 5C4	AB	T Ionicel
Woodlands	5 Woodstock Rd SW	Calgary	T2W 5V8	AB	M Hackett
Hermitage	570 Hermitage Rd NW	Edmonton	T6K 4C1	AB	G Vargas
Millwoods	2953-66 St NW	Edmonton	T6K 4C1	AB	C Ramos
Leduc	5010 48A St	Leduc	T9E 6Y1	AB	D McCoombs
Eastview	#4 Ellenwood Dr	Red Deer	T4R 2E3	AB	D Lorencz
Oriole Park	86 Osler Cr	Red Deer	T4P 4C1	AB	N Owen
Riverside Meadows	5432 Kerrywood Dr	Red Deer	T4N 4X2	AB	J Hermary
Sherwood Park	20 Main Blvd	Sherwood Park	T8A 3W8	AB	K Heroux

Glossary of Terms

Acquisition Costs – these are expenses that are connected with purchasing an already existing business that do not become part of the book value of the business. These expenses would include items such as legal fees, lenders fees, finder fees, mobilisation costs, employee buyouts, etc.

Book Value – This is the value as represented on the Statement of Financial Position that represents the amount paid for the assets of an organisation less the amount that the organisation owes to third parties.

Capital Costs – These are costs that represent the lasting value of purchased items. Capital Costs would include items such as Land, Buildings, Equipment, Goodwill, etc.

Cash Flow – is the measure by with most investments are evaluated. The concept of cash flow takes into account the ability of an organisation to generate cash from operations balanced against the need to use cash for replacement or expansion. The return to a shareholder is paid out of cash that an investment generates that is not needed to maintain the investment.

EBITA – This is a financial concept for evaluation of the earnings from an organisation. The acronym stands for: **E**arnings **B**efore **I**nterest, **T**axes and **A**mortisation. The purpose of making this calculation is to determine the ability of an organisation to generate profit before considering the impact of investment. The reasoning behind this is that if an organisation can't generate a positive EBITA then no amount of investment is worthwhile. It is the amount of EBITA over time that indicates to an investor how much the organisation is worth or how much investment makes good economic sense. Once this is known the investor can, in theory, make an informed investment decision.

Goodwill – This item represents an amount paid for a business that is not part of the value of hard goods such as Land, Buildings and Equipment. The reason for Goodwill comes about when the operating value of a business is greater than the value of the hard goods on the books. There have been substantial recent changes to the accounting rules for Goodwill that favour a company that is attempting to present a profitable position even though the company may not be generating enough revenue to cover the cost of the initial investment.

Market Value – This is the amount that is calculated when the number of shares of a public company is multiplied by the market price for the shares. The Market Value calculation is often used in conjunction with the Book Value calculation to determine whether the shares are over or under priced on the stock market. Other terms that this concept is known by are: Market Valuation or Market Capitalisation.

Operating Margin – This is an accounting concept that is an attempt to separate costs with different behaviour in order to improve decision making and analysis. The cost behaviours that are being separated are costs that change directly with the amount of revenue generated and costs that are independent of revenue. A cost that changes directly with revenue is called a Variable Cost. Examples of Variable Costs in a Child Care would be wages, food, programming, etc. A cost that is independent of revenue is called a Fixed Cost. Examples of Fixed Costs in a Child Care would be rent, insurance, administration, interest, property taxes, etc. The Operating Margin takes into account the difference between Revenue (fees and subsidies) and the Variable Costs. The use of an Operating Margin calculation in a Child Care setting is not as useful as for other types of organisations because very few of the Variable Costs are truly variable, there is a very small proportion of Fixed costs and the Revenue does not vary significantly over time.

Premium on Book Value – This is the amount by which the Market Value exceeds the Book Value. It is usually expressed in terms of a percentage.

Price/Earnings Ratio (P/E Ratio)– This is a measure of the value that a business is creating (earnings, expressed as earnings per share) divided into the market value of a share. The ratio is used to determine the relative value of a business. While the concept is simple the application can get quite complex depending on how the earnings are being defined. There is a relationship between the perceived risk of the investment and the P/E Ratio. The lower the P/E Ratio the higher the perceived risk. However, in a speculative market the price of a share may bear no resemblance to the risk profile if the shareholders have been lead to believe really good things are about to happen.

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