UK HEALTH & SOCIAL CARE

JULY 2023: M&A SECTOR TRENDS

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CONTENTS

CURRENT MARKET DYNAMICS

Headwinds beginning to ease as the sector adapts to evolving challenges

Welcome to BDO UK's 2023 Health and Social Care Report

The UK Health and Social Care sector provides critical infrastructure and services to look after some of our society's most vulnerable – it is a necessary function of welfare and is supported by a wide spectrum of operators.

In this report we review sector performance, key current considerations and operator focus looking forward. We focus here on elderly, adult specialist, children's specialist and domiciliary care.

This is a sector that has survived both the impact of COVID and the current workforce and inflationary pressures. Overall, it has demonstrated its resilience and fundamental ability to deliver high quality care for the most vulnerable in society. This is underpinned by growing demand for healthcare services and the sector's ongoing response to the pressures faced.

Within this, there clearly are winners and losers, and a need for the sector to continue developing services and technology – to provide high quality offerings that customers require, with a business model that investors support.

Key Current Considerations

There clearly are challenges at present, but the sector is on a path to finding and implementing solutions.

Arguably, the most significant challenge remains staffing, in particular cost and scarcity. Operators have focused on initiatives to retain staff: training, career paths, clarity of culture, all of which have successfully limited their exposure to agency staff, thereby protecting margins. International recruitment is also now being used across the sector as a solution and is increasing the overall pool of carers and nurses in the UK.

Costs have increased - rising energy and staffing costs, as well as broader inflation, is well documented, leading to nervousness around what funding increases could be agreed with Local Authorities and Integrated Care Boards. Whilst higher funding increases would assist across the sector, we understand the average increases have been above historical trends and have (at least to an extent) reflected cost rises.

In order to counter inflation, the Bank of England has continuously increased interest rates from late 2021, increasing debt service burdens on operators. This has impacted leveraged providers, and arguably slowed the pace of some sector consolidation in the past nine months,

The above challenges have significantly impacted deal volumes in H1 2023, which is discussed in greater detail across the following pages.

On the positive side of the equation, the elderly market demand is underpinned by the long-term trend of an ageing population and, comparatively, reducing availability of supply. In addition, post COVID this sector has seen a return to more normal levels of occupancy and EBITDA[(3)] margin – expected to continue in the coming months.

The specialist care market also experiences demand underpinned by increased knowledge of conditions and diagnoses over time. Demand continues to grow, with additional services being developed to provide ever more specialist and focused provision.

The implementation of technology is also driving efficiencies as the sector looks to improve technology platforms across multiple care settings, provide real time information and increase the use of virtual monitoring of customers. This is an exciting part of the sector's growth and development in the next 18 months. Continued consolidation also offers a route to manage the inflationary environment and deliver efficiencies – consolidation remains a key growth strategy for many in the sector. We see 'buy and build' strategies continuing in the foreseeable future.

Quality remains fundamental. Operators that are able to achieve high quality ratings[(1)] are able to attract greater occupancy and fees, in turn leading to stronger valuations.

On average, CQC rates 83%[(2)] of services as 'Good' or 'Outstanding'. Since COVID, inspections have become increasingly demanding and operators are focused on responding to these demands.

In addition, there is a broader requirement to concentrate on ESG, with sector leaders understanding this requires specific focus. The sector clearly leads on social impact, but all 'ESG' elements need development, and clear evidence of this is increasingly required by all stakeholders and funders.

Furthermore, just when the sector has recovered from COVID and is managing the current challenges, political uncertainty looms ahead, with an election coming in 2024/25. Amongst other things, this may lead to funding and tax changes – it is clear that change and challenges are part of the 2020s.

Overall, despite the challenges, this key sector of our economy is set to continue to deliver the fundamental care provision needed across age groups and conditions. It has demonstrated its resilience and investors clearly remain attracted by the fundamental drivers of the sector, combined with operators focused on delivering high quality, successful business plans in changing times.

(1) CQC: Care Quality Commission, CIW: Care Inspectorate Wales, CI: Care Inspectorate Scotland
(2) Care Quality Commission, as at 31.07.22, 83% of adult social care services were rated as good or outstanding
(3) Earnings Before Interest, Tax, Depreciation & Amortisation

DEAL VOLUMES - MACRO TRENDS

Volumes recovered post COVID; further tests to sector resilience in 2023

For investors overall, strong interest in the sector continues, underpinned by the long-term demand fundamentals of the care sector.

However, a number of key trends have emerged over recent years, particularly as elements of the overall sector were impacted by COVID in different ways.

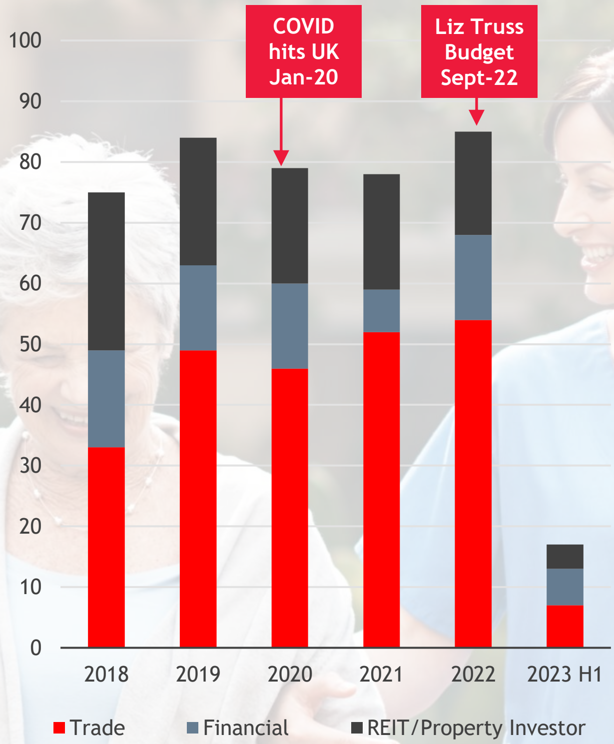
To assess trends in the sector we have analysed deal volumes based on transactions announced. We have classified transactions under Trade, Financial Sponsors and REIT / Property investors (as they have a significant impact on the sector). The chart to the right details deal volumes in the sector as a whole, covering the sub-sectors of elderly, specialist and domiciliary care - which we individually review on the following pages.

Looking at overall deal volumes, the analysis appears to indicate a rising number of transactions pre-COVID, with a drop in 2020 and 2021, before returning to growth in 2022. Considering the macro-trends the sector faced overall, prior to the current year, deal volumes remained relatively buoyant - management teams and investors reflecting their commitment to the ongoing growth and development of the sector.

By the beginning of 2023, as the pressures of COVID subsided, the sector had to further contend with cost and workforce pressures, as well as increases in the cost of capital. These factors acted to significantly reduce transaction volumes in the first half of 2023, as management focused on operational challenges. The sector has now significantly adapted to these pressures, and we anticipate a recovery in deal volumes coming through in the second half of 2023 and into 2024.

The data also indicates financial investors (including REIT / Property Investors) reduced as a percentage of overall deals completed in the period but have remained committed to the sector, returning to strength and supporting c.36% of transactions in 2022.

Overall Deal Volumes(1)



There is an increasingly broad range of financial investors attracted to the various sub-sectors, including REITs, Infrastructure Funds, property focused Private Equity, and 'conventional' Private Equity, alongside banks and debt funds.

We expect this trend for diversity of investor to continue in 2023/24, with more international investors also becoming a feature of the health and social care market.

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) The chart will inevitably not include all transactions and focuses on those that are relevant from the sources used

ELDERLY CARE
Resilience through COVID and current challenges

The elderly care home sector represents the largest segment of the health and social care sector and is unsurprisingly the leading contributor to overall deal volumes.

Looking at deal trends in this sector in isolation, we see the real impact of COVID, reflecting the tough time for the care home sector – with a sharp decline in 2020. Operationally challenging, the sector took a big hit in occupancy, which is only now returning to near pre-COVID levels and is expected to continue to rise given underpinning demand.

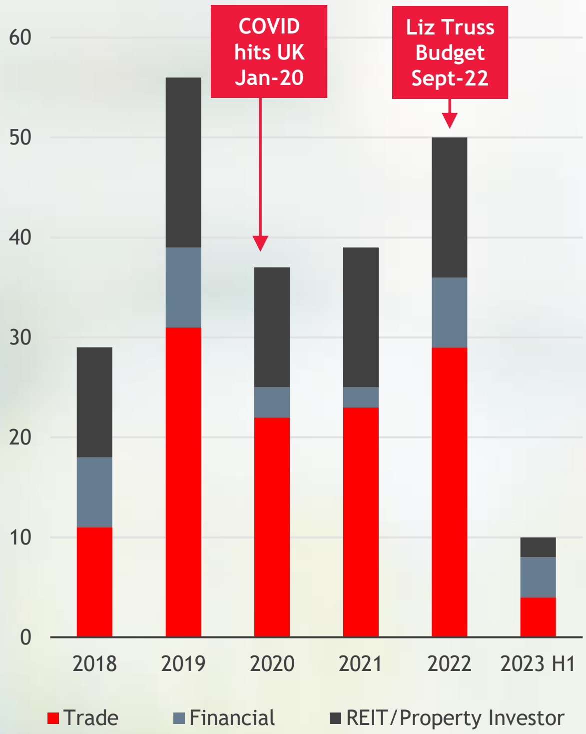
With respect to staffing, the sector has been partly reliant on agency staff over the last few years, which directly impacts profitability. This has been an acute challenge across healthcare in 2023, but elderly care homes have had success in implementing solutions by way of overseas carers / nurses – which works particularly well for large single sites, where food and accommodation can be relatively easily provided.

There have clearly been those forced out of business and smaller operators who are struggling with COVID impact, costs and operational issues. However, overall, we see the elderly care home sector as one that has shown strong operators can survive and deliver profits to support sustainable growth – having survived both COVID and current pressures.

Coming out of the pandemic deal volumes continued to rise, as illustrated over 2021 - 2022. Whilst the first half of 2023 was impacted by staffing and inflationary pressures, these are beginning to subside and looking forward the expectation is transaction volumes will increase as longer-term trends drive strategic investment. Deals should also become more straightforward to assess, as COVID related adjustments will no longer impact current EBITDA financials.

M&A activity in the sector benefits from the property ‘underpin’ of operations. Many recent transactions (c.28% in 2022) have been supported by real estate investors – with REITs being significant investors in the elderly care home market. This activity has also led to the development of the ‘Opco’ model – with a number of Opcos now of significant scale, offering a ‘property light’ model for further growth.

Elderly Deal Volumes(1)



In addition, there has also been a recent increase in the number of European investors entering the UK, including the acquisition of Balhousie Care Group by AcalisCare and Berkley Care Group by Korian.

Given demand dynamics, a few operators leaving the market and the requirement for continued efficiency gains, we see an ongoing drive for consolidation and investment going forward; buy and build strategies deliver returns in the sector both through economies of scale and the potential for multiple arbitrage.

With respect to new developments, economic factors are resulting in extended build times and increased costs, with purpose-built developments currently being priced at historical peaks. Given these high costs combined with extending timescales, more support is expected for M&A as the driver for growth for leading operators in the sector.

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) The chart will inevitably not include all transactions and focuses on those that are relevant from the sources used

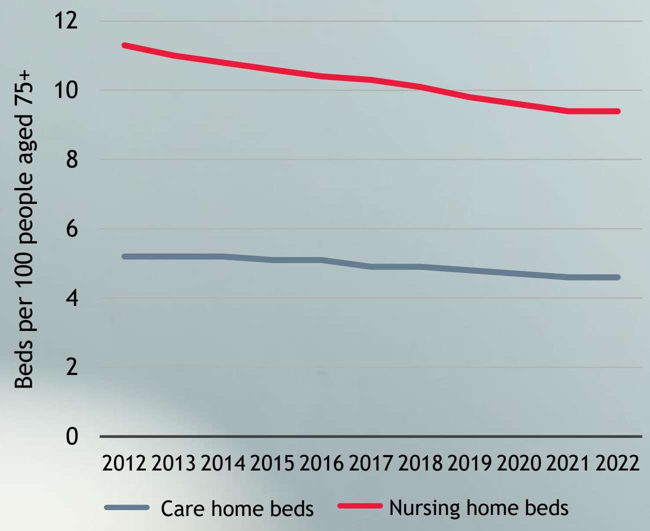
ELDERLY CARE

Increasing demand, decreasing supply

It is well understood that the sector is underpinned by demographic drivers – with a growing ageing population. Another key driver is the long-term trend of capacity struggling to keep pace with demand.

The Census 2021 results confirmed that over 11 million people – 18.6% of the total population were aged 65 years or older, compared with 16.4% at the time of the previous Census results in 2011. In addition, the care home and nursing home bed availability for older people in England has been decreasing over time.

This combination generates a strong, systemic level of demand which bodes well for the forward-looking viability of the sector, continuing to attract investors and operators and underpinning valuations in the sector.



Sources: Office for National Statistics, Office for Health Improvement and Disparities

ELDERLY CARE

Selection of Marquee UK Elderly Care Transactions

Date[1]	Target	Acquirer
May-23	Portfolio of care homes located in Northern Ireland	Welltower Inc
Feb-23	BN Care	BGF
Jan-23	Portfolio of 6 homes in Shropshire & Cheshire from Morris Care	Impact REIT
Nov-22	Portfolio of 4 care homes	Omega REIT
Oct-22	Newly built care homes in Aldershot	Hartford Care
Oct-22	Beaufort Park Care Home and Retirement Village	Agincare
Oct-22	Cornwall Care Limited	Sanctuary
Sep-22	Balhousie Care Group	AcalisCare
Jul-22	Halcyon Care Homes	Anchor
Jul-22	New Century Care	Gresham House; Salutem; BSIF
Jun-22	Care homes in West Midlands	Kingsley Care
Apr-22	Portfolio of 5 care homes of Hamberley Care	Rynda Healthcare
Apr-22	LV Care Group	Groupe Emera
Mar-22	Lovett Care	H.I.G. Capital
Mar-22	Portfolio of 29 Northern Ireland care homes from Four Seasons	Beaumont Care
Feb-22	Avery Healthcare	Reuben Brothers
Dec-21	Century Healthcare	Renal Health
Dec-21	Portfolio of 18 care homes in Weymouth	Target REIT
Oct-21	Care homes in S.E. England	Eleanor Healthcare Group
Jul-21	Portfolio of 3 care homes in E. and S.E. England	Cofinimmo SA
Jun-21	Portfolio of 13 Northern Ireland care homes from Four Seasons	Ann’s Care Homes
Apr-21	HC-One recapitalized	Welltower Inc, Safanad
Apr-21	Sentinel Health Care	Moorfield Group; Allegra Care
Mar-21	Berkley Care Group	Korian
Jan-21	Portfolio of 3 nursing homes	Aedifica SA
Dec-20	Portfolio of 8 new care homes from LNT Care Developments	Octopus Healthcare
Nov-20	Ashberry Healthcare	MBO backed by Cambridge & Counties Bank
Apr-20	Portfolio of 11 care homes across S. England from Four Seasons	Barchester Healthcare
Mar-20	Portfolio of 9 Scottish from Holmes Care Group	Impact REIT
Jan-20	Portfolio of 5 care homes	Aedifica SA
Nov-19	Portfolio of 24 care homes from Brighterkind	Barchester Healthcare
Jul-19	Portfolio of 5 care homes in Yorkshire	Aviva; Anchor
May-19	Portfolio of 7 care homes	Impact REIT
Jan-19	Portfolio of 7 care homes	Octopus Healthcare
Oct-18	Portfolio of 4 care homes	Octopus Healthcare
Jun-18	Signature Senior Lifestyle	Revera Inc

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) Date transaction announced

SPECIALIST CARE

Track record of interest from financial investors

This sector primarily consists of specialist adult care, mainly residential and supported living care for individuals with learning disabilities and mental health challenges. It is a market with typically higher average weekly fees, reflecting the more complex care provision delivered in this sector.

As illustrated on the chart, deal volumes in adult specialist care are lower than elderly care, reflective of the fact it is a smaller part of the overall health and social care market.

Looking at deals in this sector, we see a slightly different trend to that in elderly care. The peak for transactions here was 2018 – with 2020 bouncing back from 2019 as investors deliberately returned.

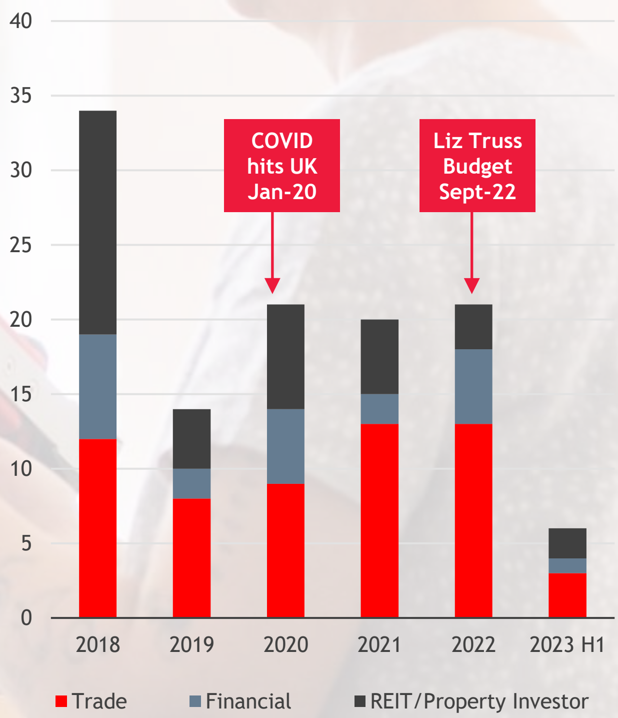
The adult specialist care sector saw a significant number of 'platform' deals completed between H2 2020 and H1 2022. This sector quickly demonstrated its resilience during COVID – with clear demand remaining from Local Authorities and CCGs for specialist adult care, and a more limited impact from COVID in these homes due to the predominantly younger demographic.

Prior to the 2022 debt market disruption, it was not apparent that appetite for transactions had significantly dropped, but understandably this sub-sector was (in line with the health and social care market overall) impacted by funding, staffing and inflationary pressures in H2 2022 and H1 2023.

Nonetheless, demand remains high for good quality providers focused on niche specialist care provision. Specialist care continues to attract broad financial investor support, principally private equity and infrastructure. Infrastructure funds have been attracted to this particular sector due to its long-term care characteristics leading to relatively foreseeable revenue streams over the medium to long term. REIT / Property deals are slightly less prevalent in specialist care compared to elderly care, and are largely dominated by CIVITAS.

It is a market that particularly suits a buy and build strategy attractive to financial investors, and we see this continuing going forward – indeed most of the larger trade consolidators are either private equity or infrastructure backed. As such, there is a driver for the specialist care market to continue to be active, with a focus on high acuity, high quality businesses – demonstrated by the number of significant deals completed over the past few years with private equity and infrastructure backing, as stand-alone platforms or as trade consolidation.

Adult Specialist Care Deal Volumes[1]



Specialist care valuations held up strongly in 2020, 2021 and into 2022. Driven by significant demand for both new platforms (from PE investors) and also for growth in existing portfolios – the market was to an extent supply constrained, and valuations benefitted from this.

In the current climate, there is perhaps greater pressure on the specialist sector in terms of availability of suitably skilled staff. This is also having an impact with EBITDA margins under more pressure than pre-COVID and, combined with the impact of the debt market, this has had a knock-on impact on deal volumes in H1 2023.

However, specialist and high acuity providers continue to be particularly attractive, given their 'essential service' income streams are more protected from public sector funding cuts and will benefit from continuing underlying growth trends. In recent years, the largest deals have attracted strong valuations and we expect liquidity flow to return to the sector as funders drive bolt on acquisitions.

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) The chart will inevitably not include all transactions and focuses on those that are relevant from the sources used

SPECIALIST CARE

Children's sector; quality is vital

Specialist care and education for children is a critical sub-sector that frequently sees consolidation, with a number of larger platforms being private equity backed.

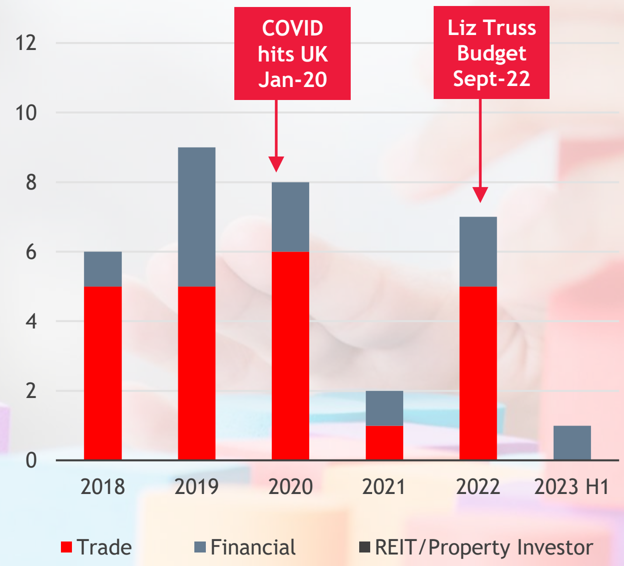
The children's sector has fewer transactions compared to adult specialist care, largely due to its scale. This sector is also impacted by potentially greater reputational risks as high quality is so critical – which can cause investors to have even deeper due diligence requirements.

Deal volumes illustrate a growing number of transactions between 2018 and 2019, with a slight decline in 2020 but still displaying resilience. In March 2021, The Competition and Markets Authority's launched a market study into children's social care provision which caused a pause in sector consolidation in 2021, pending the outcome of the report. Following the report being published in March 2022, investors returned to the sector with ongoing support for high quality operators and in line with the findings of the report.

Ofsted also now requires all supported accommodation providers for looked after 16 and 17 year olds to register with them and meet their standards from October 2023, with inspections beginning nationally from April 2024. Regulation of this sector further underpins quality of care and supports further investment in the important 'bridge' between children and adult specialist care.

Whilst H1 2023 has limited transactions; in part due to current market pressures, size of the sub-sector and added regulations, we expect investor interest to return going forward.

Children's Care Deal Volumes[1]



In common with our review of other health and social care sub-sectors, the children's sector also has workforce and cost pressures. However, consolidation is expected to continue to be pursued to deliver benefits of scale for those focused on delivering high quality care.

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) The chart will inevitably not include all transactions and focuses on those that are relevant from the sources used

SPECIALIST CARE

Quality, scarcity, resilience and a supportive investor pool underpin M&A

Specialist care conclusion

Coming into the second half of 2023; there is potentially a gap developing between acquirors' and vendors' views of valuations in specialist care. With vendors still aware of the levels of valuation achieved in the past and focused on achieving a good outcome. Acquirors are likely to point to EBITDA margins under pressure and having to contend with more challenging funding markets with higher interest rates than in recent times.

However, there remains a relative scarcity of privately owned operators of scale in the £5-15million EBITDA range; so the expectation is that they will continue to attract investor interest in 2023, and sector valuations will continue to be supported – as demand from consolidators is expected to continue to outstrip supply in this part of the market. This is underpinned by the long-term fundamentals inherent in specialist care (offering a comparatively 'safe' investment when compared to the uncertainty of demand experienced by other (non-healthcare) sectors, provided high quality is being delivered) and headwinds (i.e. workforce & cost pressures) in the sector beginning to alleviate.

SPECIALIST CARE

M&A outlook - supporting transaction volumes

Key transactions in the sector have continued to be supported by the entrance of new investors

Larger platforms have also sought to complete significant numbers of bolt-on acquisitions

Significant opportunity for further buy and build to enhance efficiencies

Underpinned by a focus on high quality care provision

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) The chart will inevitably not include all transactions and focuses on those that are relevant from the sources used

SPECIALIST CARE

Selection of Marquee UK Specialist Care Transactions

Date[1]	Target	Acquirer
Mar-23	Zero Three care	Montreux
Feb-23	Stepping Stones Services	Optimo Care
Jan-23	Cavendish Care	Ivolve
Dec-22	Portfolio of specialist care homes acquired from CareTech	Civitas
Dec-22	CFS and CHAD	Swanton Care
Oct-22	H.W.C.G.S. Care	Potens
Sep-22	Recovery Care	Accomplish
May-22	Portfolio of 6 specialist facilities from Hamberley	Octopus Real Estate
Apr-22	CareTech	Consortium[2]
Mar-22	Blue Ribbon Healthcare	Queen's Park Equity
Jan-22	Voyage Healthcare	Wren House
Jan-22	The Huntercombe Group	Active Care
Dec-21	Elysium Healthcare	Ramsay Health Care
Sep-21	Sequence Care (rebranded to Liaise)	Intriva Capital
Aug-21	Witherslack Group	Mubadala Capital
Jul-21	RNID's care and support services	Achieve Together
Jan-21	Consensus Support Services	Stirling Square
Jan-21	Procare Wales	Tristone Healthcare
Dec-20	Priory Group	Waterland PE, MPT
Nov-20	Portfolio of 11 specialist care sites of The Huntercombe Group	Montreux
Nov-20	Heathcotes Group	Civitas
Nov-20	Exemplar Health Care	Ares
Oct-20	Bryn Melyn Care	Outcomes First Group
Jul-20	Oracle Care	The Esland Group
Jul-20	A Wilderness Way	BGF
Apr-20	Holmleigh Care Homes	Ancala Partners
Dec-19	Christchurch Group	Montreux
Nov-19	Pebbles Care	Ardenton Capital
Sep-19	Horizon Care and Education	Graphite Capital
Sep-19	Portfolio of 40 homes from Voyage Care	Triple Point REIT
Aug-19	Portfolio of 16 specialist care home from Leonard Cheshire	Valorum Care Group
Aug-19	Outcomes First Group	The National Fostering Agency
Aug-19	Cressey College	Horizon Care and Education
Jun-19	Aspirations Care	Elysian Capital
Mar-19	Portfolio of 21 regulated social housing properties in E. and W.	Civitas
Feb-19	Esland Care Group	August Equity
Jan-19	Partnerships in Children's Services	Core Assets Group
Dec-18	TLC Care Homes	Civitas
Dec-18	Care Management Group	AMP Capital
Oct-18	Choice Care Group	iCON Infrastructure
Sep-18	Care homes in Hampshire	Cornerstone Healthcare
Jul-18	Danshell Group	Cygnet (UHS)
Jul-18	Cambian Group	CareTech
Apr-18	The Hesley Group	Antin Infrastructure
Mar-18	Scope's regulated and day care services	Salutem
Jan-18	Active Assistance	Montreux

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) Date transaction announced
(2) Sheikh Holdings Group (Investments) Limited; THCP Advisory Limited, Asset Management Arm; Kensington Capital Limited; Belgravia Investments Limited

DOMICILIARY / HOMECARE

In contrast to other sub-sectors, the characteristics of homecare enabled it to benefit from customer trends emerging during COVID

The homecare sub-sector includes elderly and specialist care being provided in an individual's own home.

Homecare remains a highly fragmented market, which also supports buy and build strategies.

Between 2020 – 2021, COVID boosted deal volumes in the sector as customers opted for care in the comfort of their own home rather than potentially higher risk residential care settings and consolidators acted quickly to support this growth in demand.

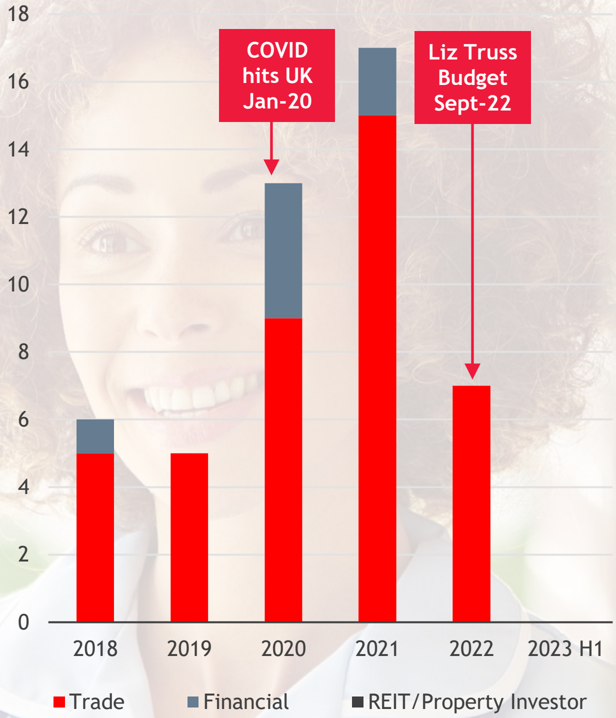
There have been a number of consolidators attracted to the market, seeking to build platforms across the country, many private equity backed (City & County, Grosvenor, Optimo) – as well as Cera Care.

Funding has supported ongoing consolidation, albeit there has been a refinement of strategies, with certain operators focusing on private pay and specialist care to protect margins.

The material challenge in the sector has (always) been to sustain margins, with staffing costs coming under pressure again recently with the rise in national living wage to £10.42 in April 2023. This means that there are two main business models for success in the sector; focus on LA funded care at scale and with technologically enhanced efficiencies or, to focus on specialist, higher fee, home care – ensuring that high quality is maintained at all times.

Post COVID the sector has stabilised, and appetite for acquisitions remains, reflected by Cera Care's successful debt and equity fund raise of c.£260 million last year.

Domiciliary Care Deal Volumes(1)



We expect buy and build strategies to continue, but for there also to be a higher focus on technological developments – including investment in efficient systems, and further use of remote monitoring.

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) The chart will inevitably not include all transactions and focuses on those that are relevant from the sources used

DOMICILIARY / HOMECARE

Selection of Marquee UK Domiciliary Care Transactions

Date[1]	Target	Acquirer
Nov-22	My Life Choice	Optimo Care
Sep-22	Safe Hands Support Services	Optimo Care
Jul-22	Premier Homecare	Trinity Homecare
Mar-22	CSN Care Group	Clece Care Services
Dec-21	CDA Care	Grosvenor
Dec-21	Grosvenor Health and Social Care	Weight Capital Partners
Oct-21	Health Care Resourcing Group (CRG)	Cera Care
Sep-21	Berkeley Home Health	Trinity Homecare
Jun-21	Routes Healthcare	Palatine PE
Jun-21	Premier Care Management	Tristone Healthcare
May-21	Sunshine Homecare	Nobilis
Apr-21	MC Care	City & County
Feb-21	Charmes Care	First City Nursing Services
Dec-20	City & County	Summit Capital Partners
Oct-20	OCS Care’s domcare business	Premier Care
Sep-20	Mears Group's Scottish domcare business	Cera Care
Aug-20	Trinity Homecare	Consolidated Healthcare Agencies
Aug-20	Gemcare South West	Cera Care
Mar-20	Patricia White's and Country Cousins	Limerston Capital
Feb-20	Mears Group’s English and Welsh domcare business	Cera Care
Nov-19	The Human Support Group	City & County
May-19	Rainbow Care Services	Grosvenor
Apr-19	The Good Care Group	Sodexo
Jan-19	Radcliffe Home Help, Advanced Community	Cera Care
Dec-18	Nestor Primecare's UK domcare services	Health Care Resourcing Group
Dec-18	Allied Healthcare	Health Care Resourcing Group
Mar-18	Helping Hands Home Care	Livingbridge
Feb-18	Ark Home Healthcare	City & County[2]

Sources: S&P Capital IQ, Mergermarket, FAME, BDO market intel, public information
(1) Date transaction announced
(2) City & County acquired majority of Ark’s branches, with MiHomecare and Westminster Homecare also acquiring some branches

WHAT IS ON THE INVESTOR'S AGENDA?

An outlook of key attributes for 2023 / into 2024

Across health and social care services, there are a number of factors that underpin investor appetite:

Quality of care – 83% or above 'Good' or better(1)	Strong management team	Future proofed service offering	Property underpin	Geographical location / scale vs clusters
Stable financial profile and growth trajectory	Demand for services vs. staffing	Innovative solutions	Incorporation of Technology	ESG

Quality of care

- Quality is fundamental – issues can represent a threat to reputation and financial performance
- Most private equity, infrastructure investors and debt funders will focus on 83% or above 'Good' ratings (but really seeking 100%).

Capable management team

- Operators with a capable management team with proven track record in social care.

Future proofed service offering

- Resilient to future pandemics and economic downturns
- Socially necessary services
- Specialist / niche.

Property underpin

- Not applying to all sub-sectors, but where available property can offer valuable security for debt providers
- Number of funds express a preference for property backed assets, but also focus on the acuity of care and ability to generate long term cash flows.

Geographical location and scale

- Location is key to assessing fit within existing regional structures
- Footprint is often taken as a proxy for financial profile.

Stable financial profile and growth trajectory

- Focus on strong occupancy, average weekly fees and staffing model
- EBITDARM(2) margins: maintain margin despite cost pressures; margins vary between sub-sectors – key is to be "best in class" whilst maintaining focus on quality
- Pathway to future sustainable growth is key; underpinned by relationships with commissioners.

Demand for services vs. staffing

- Clear understanding of staffing availability
- Focus on recruitment, retention, training and culture
- Able to describe sustainable staffing policy, in light of 2023 work force constraints.

Innovative solutions

- Providing services which can assist the NHS; preventative / nursing / wait list management.

Incorporation of Technology

- Technology providing quicker and more accurate monitoring and diagnostic information
- Back-office management systems that allow staff to focus more of their time on the provision of care.

Environmental, Social, Governance

- Underpins reputation and future readiness.

(1) Care Quality Commission, as at 31.07.22, 83% of adult social care services were rated as good or outstanding
(2) Earnings Before Interest, Tax, Depreciation, Amortisation, Rent & Management charges

WHAT IS ON THE HEALTHCARE LEADER'S 'FORWARD' AGENDA

Being pro-active will be key

Looking to the future, there are opportunities ahead, involving innovation and development supporting the overall growth of services in health and social care.

Growth hotspots

Chronic condition management

It is inevitable that adult patients living longer, with challenging conditions, will require more specialist care. Preparation and further convergence of health and social care will be essential.

Proactivity in personal health

As pressures increase across the health system, there is going to be an increase in need for care options and services such as diagnostic facilities. Employees have greater focus on health benefits, driving greater demand.

Mental health

Mental health is increasingly a key health issue. Rates among children have risen especially quickly, and access to specialist help can be a challenge. Services that assist in identifying and swiftly treating mental health issues at an early stage are increasingly important.

Specialist Care

There is an ongoing drive towards delivering high quality positive outcomes in the sector. Maintaining this culture and responding to workforce pressures are key.

Innovative recruitment and retention

A focus on overseas recruitment will help alleviate short-term pressure in the non-specialist sector, whilst retention factors might include support for workers during the cost-of-living crisis and setting out a clear path to career progression.

Working with the NHS

Freeing up beds and services, reducing wait list times in hospitals by placing individuals in appropriate care settings in the health and social care sector.

WHAT IS ON THE HEALTHCARE LEADER'S 'FORWARD' AGENDA

Investment in technology and consolidation

Short Term Technology Opportunities

- Investment in technology is becoming critical. As well as offering potential efficiencies, new ways of providing care to customers, better data collection and analysis, investment into internal systems is key to free up staff time to allow them to focus on delivering high quality care.

There are a few clear themes:

- Digitisation of records – This will provide clear, immediate benefits, for example, in terms of providing feedback on cases of COVID and other infections, obtaining up to date information on individuals health history and needs, and other data
- Monitoring and diagnostics – Individuals being monitored using technology that immediately alerts staff to any unexpected deviations from the norm
- Back-office development – While internal investment into efficient and operational improvements in back-office systems will be an immediate cost, it will deliver medium and longer-term benefits, in terms of efficiencies, data and quality.

Consolidation Opportunities

- The sector lends itself to buy and build strategies, with acquisitions enabling margins to be supported. Consolidation can deliver broader efficiencies across portfolios and support investment. Staffing challenges, in particular, can be addressed more easily where there is a large site, or multiple sites located in close proximity. However, culture and quality need to be consistent and maintained across portfolios as they grow, with an even greater focus on supporting the management teams delivering high quality care.
- Consolidation is expected to become increasingly international, with European and US investment into the UK health and social care sector, and UK investors and funders looking at opportunities across Europe.

TAX IN HEALTHCARE 1/3

Increasing costs focus attention on cash tax and other opportunities for savings

Turning our attention to tax, opportunities for cash tax savings and other cash savings are high on the agenda as is protecting value in the business with strong compliance and attracting, retaining and incentivising employees. Outlined below are some of the key tax related issues our health and social care tax specialists are being asked about.

Cash tax savings opportunities

Capital allowances

The capital allowance announcements made by the Chancellor in his Spring Budget provide a welcome continuation of the acceleration of tax relief for healthcare businesses investing in qualifying capex. These new reliefs take effect from 1 April 2023 when the current "130% super-deduction" expires. For healthcare businesses carrying out care home construction, refurbishment work on their care home portfolio or other capital expenditure projects, the reliefs provide an opportunity to reduce the effects of the main rate of corporation tax rising to 25% from 19%.

Under the measures there is "full expensing" (or a 100% first year allowance) for qualifying expenditure on new and unused main pool plant and machinery as well as temporary 50% first year allowance on new and unused special rate plant and equipment.

The annual investment allowance remains at £1m which is helpful, particularly for smaller businesses.

Deductibility of interest

Interest continues to have the potential to provide valuable tax shelter from the profits and gains of healthcare care businesses. The tax treatment of interest remains complex, particularly for larger businesses and private equity backed businesses, and there are a number of areas to consider including

- Transfer pricing
- Corporate interest restriction
- Hybrid rules
- Late paid interest rules
- Withholding tax obligations.

Availability of losses

For businesses with tax losses reviewing the nature of the losses and understanding their availability going forwards is key. The current loss rules are flexible the way in which losses can be utilised but also include caps on the amount of losses that can be used in each period. Where businesses have undergone changes in ownership there are also rules which may limit the availability of tax losses. Early planning is often worthwhile to maximise access to the available shelter.

Other cash saving opportunities – group simplification

Healthcare businesses often grow through acquisition which can result in overly complex group structures. For these businesses there can be a number of benefits from undertaking group simplification.

- Annual cost savings – Growth of the number of entities in a group leads to significant increases in annual compliance costs (audit, tax etc.). Rationalising the number of companies helps to control the compliance cost burden
- Directors' responsibilities – Running a company carries a burden for the directors in terms of corporate governance and risk management. Simplifying the group and reducing the number of legal entities helps to manage that burden
- Management time saving – Decreasing the number of entities reduces the time spent managing the group's annual compliance by key personnel which allows them to focus on other areas
- Extraction of profits – Reducing the number of companies, and in particular resolving any negative reserve issues simplifies future profit extraction
- Exit readiness - Longer term, simplification of a group's legal structure has the benefit of making the group easier to understand by a potential investor on a future transaction as well as simpler to diligence.

TAX IN HEALTHCARE 2/3

Protecting value through strong compliance remains important

Protecting value

National Minimum Wage (NMW)

For several years, the Mencap sleep-ins case dominated the headlines in respect of NMW. The Supreme Court decision means that whilst this remains an area for caution, healthcare businesses have some certainty on how the NMW applies in this area.

HMRC's enforcement of NMW within the sector continues to increase and we are also seeing HMRC target specific geographic regions in addition to revisiting employers who have been the subject of a previous NMW enquiry.

The areas typically challenged by HMRC include:

- Travel time such as time between client visits
- Unpaid working time such as shift handover time
- Recruitment processes often linked to training
- Uniform costs often where an employer requires a worker to buy specific clothing which is not reimbursed
- Deductions from pay commonly related to recovery of training costs at the end of employment.

To help ensure compliance and mitigate the potential risks of HMRC enforcement, establishing appropriate employment policies and NMW controls is crucial

As a reminder, NMW breaches can lead to penalties of up to 200% of the underpayment in addition to the need to make good the underpayment itself and the reputational damage from being publicly named and shamed can prove extremely detrimental.

VAT

Most of the key income streams in the healthcare sector are exempt from VAT, as such VAT creates an absolute cost for entities operating in the sector as well as presenting a number of areas of increased risk.

Healthcare businesses commonly have significant property interests and the complexity of VAT legislation and case law in this area mean that obtaining appropriate advice is essential. As a transaction tax, once a tax point has been created it is extremely difficult to retrospectively correct an error, and given the values involved, mistakes can be very expensive.

On a brighter note, there are a number of areas which can provide opportunities to minimise VAT costs or improve cash flow and a review of operations and VAT processes can be beneficial in identifying these, as well as ensuring compliance.

TAX IN HEALTHCARE 3/3

Appropriate rewards can help workers and assist in staffing challenges

Incentivisation and retention

Founders / management

- Once again, the Spring Budget made no announcements on individual capital gains tax rates; these remain at 20% with 10% rate available for the first £1 million of lifetime gains qualifying for business asset disposal relief
- Equity incentivisation, whilst unlikely to be appropriate for care home workers, provides an opportunity to incentivise management and there are a number of different opportunities depending on the nature and size of the business including EMI options and growth shares.

Attracting and retaining care home workers

- Many employers in the care industry continue to struggle with attracting and retaining staff. With care home employees still feeling the impact of the cost of living crisis many employers are also looking for low cost ways in which they can support and reward staff
- There are a number of ways to help staff which can give a competitive advantage in the market but as always it is important to understand the possible tax consequences. Some of the more popular ideas are set out below:

Festive awards	▶ Can be tax free by must meet the trivial benefits exemption criteria ▶ Multiple gifts may be provided (e.g. Christmas, Easter and summer) but each gift must meet the exemption.
Discounts	▶ Not a benefit in kind if there is no cost to the employer ▶ Examples include discounts at gyms, retailers, restaurants and leisure operators.
Welfare counselling	▶ A tightly drawn exemption but examples of potentially exempt counselling include stress, issues at work, debt, alcohol and drug dependency.
Free staff meals or discounted meals on site	▶ Helps ensure staff have at least one meal a day ▶ Requirement for meal to be provided on site, available to all staff and be reasonable in nature.
Interest free loans	▶ Up to £10,000 can be made interest free without giving rise to benefit in kind ▶ Write offs however small give rise to a taxable benefit and Class 1 NICs falling due ▶ Necessary to consider associated risk and cost of administering.
Salary sacrifice	▶ Can make benefits more affordable e.g. pension, cycle to work or electric vehicles and be attractive for employer as well ▶ Important to consider interaction with National Minimum Wage legislation ▶ Likely to not be appropriate for care home workers but may be attractive for home managers and head office staff.

Removing barriers to the labour market

Longer term, the measures announced in the Spring Budget to extend free childcare for working parents and introduce the provision of “wrap around care” for primary school children, which are aimed at removing barriers from parents returning to work, may provide some of the much-needed help to alleviate staffing issues in the sector. However, as the measures are to be phased in over a number of years there will be no immediate benefit and it remains to be seen how these measures will be implemented.

IF YOU ARE FACING CHALLENGES

Imperative to be proactive, rather than reactive

Adult social care is an essential service within the UK for an ever-increasing proportion of the population that attracts a high level of public interest. Understanding the challenges and constraints that operators within this sector face is key along with ensuring they have appropriate management and governance in place to identify and manage the impact to their business.

Whilst there are positive performance trends and growth opportunities, some businesses are understandably facing operational difficulties. If performance is deteriorating and not immediately addressed, the rate of deterioration can escalate. The key point to make here is there are solutions to issues if you seek early assistance.

As we have covered earlier in this report, the key factors impacting businesses are staffing, inflationary pressures, fee uplifts and funding pressures. There is also another that should be considered, capital expenditure.

The first key step will be for businesses to have a robust system for managing and forecasting cashflow and working capital requirements. These forecasts will need to factor in any legacy debts to be repaid, anticipated further increases to operational costs and any capital improvements that have been identified. Having the right information and an accurate picture of a business's financial position will assist operators' decision-making processes in terms of financial requirements and future expenditure.

BDO's Restructuring team regularly carries out independent business reviews, cash / liquidity reviews and monitoring, together with contingency planning projects for a range of clients to assist them in this process. The team also provides a range of advice on funding requirements, re-financing, restructuring and strategic options to assist care providers navigate relevant challenges.

Capital expenditure

During the pandemic, many providers reduced or halted capital expenditure as cash reserves were utilised to support working capital requirements. Looking to the future, care providers will now likely see an increase in capital expenditure requirements to address historic issues and improve the quality of services. Increased focus on environmental, social and governance principles by stakeholders such as customers, suppliers and funders may lead to some operators having to make significant property improvements in the future to meet updated standards. In addition, changes to regulatory frameworks and assessments are likely to require care providers to invest in technology and digitalising systems and operations. Whilst the long-term impact of these costs will be to improve quality and efficiencies, in the short-term operators will need to manage the capital expenditure required and associated costs of implementation.

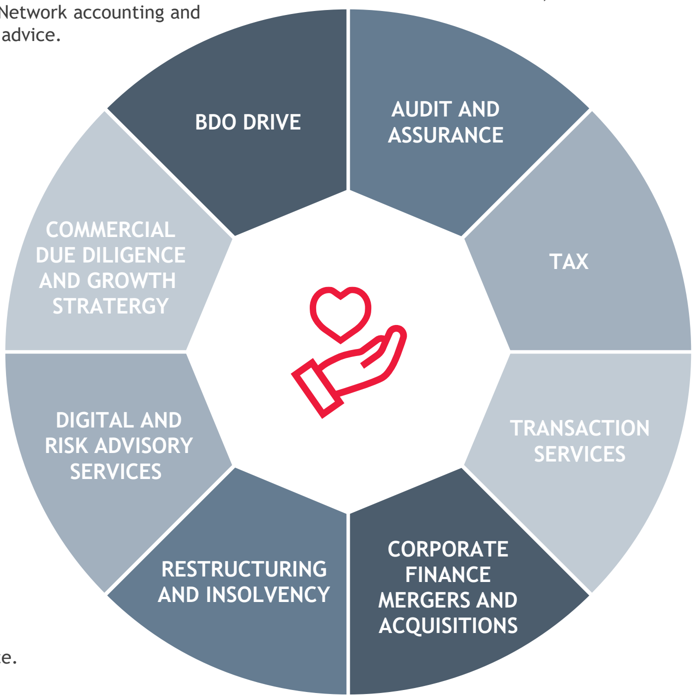
BDO HEALTHCARE SERVICE OFFERINGS

Healthcare sub-sector focus includes

- Health and Social Care Sector
- Specialist Educational Needs and Domiciliary Care
- Primary Care Services – GPs, Dentists and Pharmacists
- Not For Profit
- Medical Devices / Digital Health
- Private Hospitals / Clinics

- Partnership accounting / profit share and benchmarking analysis
- Partner taxation and superannuation returns and advice
- Incoming / retiring partner advice
- Merger analysis and advice
- Primary Care Network accounting and incorporation advice.

- Internal and external audit
- Financial reporting solutions
- Governance, risk and compliance
- Non-Executive Director programme
- IFRS, US GAAP and International GAAP.



- Growth strategy
- Buy and sell-side Commercial Due Diligence
- Pre-deal readiness, post-deal growth.

- M&A – transaction readiness | diligence | structuring | modelling a forecasting
- Financing and structure – refinancing | sale and leaseback | demergers | reorganisation | simplification
- Advisory – capital allowances | VAT | stamp taxes | CIS | NMW | employment tax I transfer pricing
- Tax compliance and tax accounting
- Tax assurance and risk management – SAO | CCO | tax strategy.

- Contract and commercial risk and third-party assurance
- Financial controls and 'UK SOX'
- Ethics, culture and compliance including fraud and data privacy
- Corporate governance and risk management
- Transformation and change management
- Co-sourced internal audit
- ESG assurance
- ERP system implementation
- Data governance and analytics
- Cyber security and business resilience.

- Buy side | vendor due diligence
- Pre-lend | lender due diligence
- Capital markets
- Operational due diligence
- Exit readiness | transaction preparation | vendor assistance
- Sale and purchase agreement (SPA) reviews
- Financial modelling | Completion accounts.

- Independent Business Reviews | Options Reviews
- Turnaround and efficiency reviews
- Accelerated Merger and Acquisition
- Formal Insolvency: Restructuring plans | CVAs | Administration
- Refinancing
- Pension advisory assignments.

- Strategic review
- Disposals
- Acquisitions
- Mergers
- Fund raising – debt and private equity
- Value creation services (including synergy assessment etc).

OUR LEAD HEALTHCARE CONTACTS

M&A

Helen O'Kane
M&A Partner
+44(0) 79660 08617
helen.okane@bdo.co.uk

Ishpal Bedi
M&A Assistant Director
+44(0) 77805 02758
ishpal.a.bedi@bdo.co.uk

TAX

Vicky Robertson
TAX Principal
+44(0) 77986 76533
vicky.robertson@bdo.co.uk

BUSINESS RESTRUCTURING

Kerry Bailey
BR Partner
+44(0) 77718 96377
kerry.bailey@bdo.co.uk

COMMERCIAL DUE DILIGENCE

Gurpal Ahluwalia
CDD Partner
+44(0) 75830 36826
gurpal.ahluwalia@bdo.co.uk

BDO TRACK RECORD

National and international presence

BDO UK

18 OFFICES
430 PARTNERS
7,070 STAFF

95% OF OUR CLIENTS WOULD RECOMMEND US[1]

2021/2022 RESULTS:
REVENUES[2] UP **11%** TO **£809m**

1. Client Listening Programme (2019)
2. Gross Revenues for BDO LLP

BDO CORPORATE FINANCE UK

362 COMPLETED DEALS IN 2022
WITH A TOTAL **DEAL VALUE** OF **£31.2bn**

67% PRIVATE EQUITY DEAL INVOLVEMENT

54% OF OUR DEALS ARE CROSS BORDER

ONE OF UK'S **MOST ACTIVE** ADVISERS*

AN **AWARD WINNING** CORPORATE FINANCE BUSINESS

300 CORPORATE FINANCE **PROFESSIONALS** IN THE UK

* #1 Financial Due Diligence provider in the UK and Ireland – Mergermarket UK account league tables by volume 2022
#1 Financial adviser by deal volume in the UK and Ireland - Experian 2020 UK M&A and adviser league tables
#2 Financial Due Diligence provider globally – Mergermarket global accountant league tables 2022

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