Eclipse
Corporate Finance

2020 Children's Services Market Review

Robust M&A activity throughout 2020

The children's services market has continued to see significant levels of M&A despite challenging conditions

- Throughout 2020, the residential children's services sector has continued to see significant levels of M&A
- The sector's resilience to the COVID-19 pandemic (through robust local authority funded fees and growing demand drivers) has further fuelled investment appetite from existing providers and new entrants
- With the majority of the largest national providers now private equity backed or publicly listed and a core element of their growth plans centred around M&A, quality groups are in high demand
- Two of the largest operators (Keys Group and Sandcastle) are currently going through their own sales processes which could lead to further consolidation amongst the national players
- Having said this, the UK market remains highly fragmented away from the largest players, providing only a limited number of suitable acquisition targets for the national providers
- This fragmented nature is allowing smaller groups to undertake their own growth strategies, which has led to various funding deals to support their expansion plans
- As we move into 2021, a number of factors are likely to influence M&A activity – these are discussed in more detail on the following pages

Outcomes First Group (innovators in care and education)	Acquisition	BMC
esland (Where we live and learn)	Acquisition	oracle care & education
keys Group	Acquisition	South West Childcare services
A Wilderness way Ltd.	Minority investment	BGF
keys Group	Acquisition	Build-a-Future (Education is the Foundation to Build-a-Future)
Young Foundations	Acquisition	Howard House & Tile Shed Cottage (Lighting the way for youth)
inspire scotland	Growth funding	THINCATS
Outcomes First Group (innovators in care and education)	Acquisition	ecs (enhanced children's services)
Young Foundations	Acquisition	Approach Development (NE) Ltd
keys Group	Acquisition	Unique Care Homes
My Choice Children's Homes	Growth funding	THINCATS
Pebbles (Nurture. Develop. Flourish)	MBO	Ardenton

Events influencing future M&A activity

Market drivers remain positive and should support continued M&A as we move into 2021

Impact of Children's Commissioner Report

- The recent Children's Commissioner report entitled "Private provision in children's social care" has again raised the issue of profiteering by privately owned operators within the market
- This has obviously resulted in a significant amount of negative press for large operators, which has coincided with the revelations at Care 4 Children
- In a market where investors are well versed on the high risk nature of these services, the Commissioner's report and ongoing scrutiny around profit levels are unlikely to slow M&A activity, however there will be more subtle consequences
- Firstly, acquirers will be more sensitive to businesses with particularly high fee levels. Whilst strong fee levels will still be a key value driver, acquirers may avoid targets with extremely high fees where there could be any suggestion that "profiteering" is taking place
- Secondly, the larger players in the sector are likely to be less public about their acquisition activity. Where deals are completed, press releases and other publicity may be limited to avoid drawing any unnecessary attention to the business

Unregulated Semi-independent Accommodation

- The provision of unregulated accommodation for children has rightly come under government scrutiny in 2020, with a ban on its use for under 16s
- There is no doubt that these unregulated services for 16 and 17 year olds need to be overseen by a fit for purpose regulatory framework, to ensure these young people have a suitable and safe home environment
- With the continued lack of capacity in registered children's homes and growing placement requirements, the provision of quality services for 16 and 17 year olds will be vital in the coming years
- When a proper regulatory framework is brought into place for these services and unsuitable providers are removed from the market, this will create even more pressure for local authorities seeking placements
- Quality providers of semi-independent living for this age group will therefore be a growth area in the market and this will no doubt lead to M&A activity as the larger players seek to establish market share
- When this takes place, however, will largely be driven by the timing of any regulatory framework, as most investors/acquirer will not enter the market until this is in place due to reputational risk

Events influencing future M&A activity

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Organic Growth vs Acquisitions

- One of the core questions for all of the leading players in the market is whether to grow through acquisition, or to do so organically
- Clearly, at first glance, organic growth appears to be the most economical option, but continued planning and registration issues for new homes make this more challenging
- This is particularly true when attempting to open services with four or more registered beds, where planning permissions remain difficult to obtain and COVID delays have not helped
- For most of the national players, the solution is therefore to use a combination of both developing new services organically and making selective acquisitions, with each opportunity judged on its own merits
- The ability and ease of opening different sizes of home organically has a direct impact on the value of businesses in the sector. More specifically, the EBITDA multiple applied to groups operating homes with 1-3 beds will be lower than those operating homes with 4+ beds
- This is because the ability to obtain planning and registration for a smaller home is generally viewed as lower risk and, as such, acquirers cannot justify applying high EBITDA multiples to businesses operating these homes
- Conversely, the groups operating larger homes (4+ beds) will achieve a higher EBITDA multiple due to their scarcity value

Small Groups Seeking Growth

- Whilst the leading national operators continue to undertake aggressive M&A strategies, they are limited by the severely fragmented nature of the UK market
- Most of the acquirers will focus their acquisition activity on groups with at least 4/5 homes and there are only a finite number of quality businesses of this scale in existence
- As such, there are a number of smaller, privately owned operators who are seeking to undertake ambitious growth strategies of their own, and this has resulted in various growth funding deals in the last 12 months
- A prime example of this is the BGF's minority investment into A Wilderness Way, the Cumbria-based provider of high acuity residential care. The investment will allow the business to fast-track its growth through the opening of new services
- Similar deals, albeit using debt funding, have been undertaken by My Choice Children's Homes and Inspire Scotland in recent months (both funded by Thincats)
- It remains to be seen whether these groups will use the funds solely to develop new homes organically or whether M&A will become a core part of their growth strategies
- Regardless, it is clear that there is room for other SMEs to undertake similar growth strategies and we see further acquisition activity for single homes and small groups as a result

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