Eclipse
Corporate Finance

Children's Services Valuation Guide

Overview

A basic guide to the valuation of children's services businesses

- This guide aims to provide a simple overview of the key factors influencing the value of children's homes
- Children's services businesses are generally valued by applying an Earnings Multiple to the profits (usually the EBITDA) of the business
- For example, an Earnings Multiple of 7x applied to EBITDA of £500k would lead to a value of £3.5m for the business
- Most valuations of this nature are made on a cash free, debt free basis (see page 6 for further details)

Underlying EBITDA

- Whilst many may think that the EBITDA of a business is fixed, it is far from it for the purposes of business valuation
- The EBITDA used to structure a valuation should be the "Underlying EBITDA" – i.e. the true underlying profitability of the business to the acquirer
- A number of adjustments are generally made to EBITDA in order to present the most favourable figure for the purposes of valuing the business – see page 3 for further details

Earnings Multiple

- Multiples within the children's services sector range broadly from c.6x to over 10x
- Numerous factors will impact the Earnings Multiple applied to EBITDA
- These factors are unique to the children's services market and should be carefully considered as part of a sale process – see page 4 for further details
- Presenting these factors in the best light and addressing any issues prior to commencing a sale process will help to maximise the value achieved

Underlying EBITDA

Presenting a credible Underlying EBITDA figure will be key in maximising value

- Presenting the optimum Underlying EBITDA for the business will have a material impact on the value achieved
- Rather than simply presenting the EBITDA from the latest statutory accounts, looking at trading performance over the last twelve months or run-rate period (often the last six months annualised) can be highly beneficial
- Exceptional costs or costs which will not continue post completion of a transaction should then be "added back" to increase the EBITDA figure
- Finally, any "pro-forma" adjustments, for example to show the true profit of new beds which have recently become operational, should then be added back
- An illustrative example is outlined in the table to the right

£	FY17	FY18	FY19	LTM*	Run-rate**	Comments
Reported EBITDA	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**EBITDA before any adjustments**
Add back costs:						
Director Salaries	[+]	[+]	[+]	[+]	[+]	May not continue post completion of the deal
Other Shareholder Costs	[+]	[+]	[+]	[+]	[+]	Examples include leasing of private vehicles, memberships of golf clubs etc.
One Off Professional Fees	[+]	[+]	[+]	[+]	[+]	Exceptional costs related to a specific non-recurring item (e.g. legal fees for a bank refinancing)
Other potential adjustments:						
Profit From New Beds	[+]	[+]	[+]	[+]	[+]	Where new beds have recently become operational, adjustments can be made to show their true value
Synergy opportunities	[+]	[+]	[+]	[+]	[+]	Potential cost savings for the acquirer post completion (e.g. the removal of certain admin staff)
Adjusted EBITDA	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**EBITDA figure upon which offers will be structured**

* Last twelve months of trading

** Run-rate figures, often looking at the last six months of trading annualised

Earnings Multiple Drivers

A number of key factors will drive the size of the Earnings Multiple applied to profits

Quality

- Ofsted ratings are the key identifier of quality for acquirers of residential children's homes and SEN schools
- "Good" and "Outstanding" ratings will attract premium multiples, whilst "Requires Improvement" or "Inadequate" ratings will materially hamper valuations

Fee levels

- Higher fee levels will drive greater multiples
- Complexity of care is particularly relevant, with higher "off framework" fees particularly attractive to acquirers
- Proven ability to charge additional hourly rates for 1:1/2:1 care is also desirable

Occupancy

- High occupancy levels are a sign that a residential home/school is operating effectively
- Consistently high occupancy levels will therefore drive greater earnings multiples

Staffing

- Adequately staffed homes/schools will drive higher margins
- Labour/fee ratios are therefore a key metric for acquirers
- Excessive use of agency staff is often seen as an area of concern

Property

- Clearly freehold property ownership will attract higher multiples than leasehold
- Well invested properties will be favoured, with acquirers reducing prices for any perceived "catch up capex" required
- Basic issues such as property access and utilities should be considered

Scale

- The scale of a business (whether nationally or within a particular region) will also impact the valuation – generally larger businesses generate higher multiples
- This applies to both the number of registered beds/places and the number of sites that a business operates

Illustrative Valuations within Children's Services

Earnings multiples range from c.6x EBITDA to over 10x EBITDA depending upon the key valuation drivers

Valuation:
6x EBITDA multiple

Ofsted Rating:
Inadequate/Requires Improvement

Scale:
Single home

EBITDA Margins: < 15%
(low fee levels, occupancy < 80%, material agency spend)

Valuation:
8x EBITDA multiple

Ofsted Rating:
All homes rated Good

Scale:
Small group (4 homes)

EBITDA Margins: > 20%
(high fee levels, occupancy > 85%, limited agency spend)

Valuation:
> 10x EBITDA multiple

Ofsted Rating:
All homes rated Good or Outstanding

Scale:
Large group (10+ homes)

EBITDA Margins: > 25%
(market leading fee levels, occupancy > 90%, no agency spend)

* All illustrations assume that the business owns the freehold property of the homes. For homes which are leased, a reduction to the EBITDA multiple of at least 2x is likely

Cash free, debt free offers

Offers will be made on a cash free, debt free basis, with a normal level of working capital

- When selling the shares of your company, the vast majority of offers are made on the basis of being "cash free, debt free"
- In simple terms, this means that any cash in the business is retained by the seller and that all debt is repaid by the seller upon completion
- Transactions should also include an adjustment to "normalise" working capital. This prevents the buyer from having to inject funds into the business if there is insufficient working capital to run the business after completion
- This adjustment is usually calculated by comparing the working capital at completion against the average working capital over the recent past
- The table on the right outlines an illustrative example of this calculation

Description	£000s	Comments
Enterprise value	**3,500**	**Adjusted EBITDA x valuation multiple**
Plus cash on balance sheet	250	
Minus debt and debt like items:		
Mortgage/bank loans	(500)	
Hire purchase creditors	(25)	
Corporation tax	(50)	Any outstanding corporation tax liabilities for the period up to completion
Deferred tax	(10)	Treated as debt if the balance will crystallise in the medium term
Plus/Minus working capital adjustment	20	Generally calculated by deducting the average working capital over the last 12 months from the working capital at completion
Equity value	**3,185**	**Value payable to the shareholders**

Why Eclipse?

Specialist advisors to the UK Health & Social Care sector

Our Experience

YOUNG FOUNDATIONS

Advisor to Young Foundations on the acquisition of a North East based residential children's home and SEN school

Positive outcomes for people

MHC

Strategic advice and financial consultancy services to Mental Health Care UK, a provider of specialist care services

Overseas Investor

Retained advisor to an overseas investor on UK acquisitions of residential learning disability homes (confidential)

CORNERSTONE HEALTHCARE

Ignite

Management buy-in of Cornerstone Healthcare, a provider of specialist residential homes, backed by Ignite Growth*

Raphael Healthcare

Elysium Healthcare

Sale of Raphael Healthcare, a provider of low secure mental health services, to Elysium Healthcare*

* Deal completed in previous role prior to Eclipse

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