Profit making and Risk in Independent Children's Social Care Placement Providers.

3rd Update Report: March 2022

Andrew Rome
March 2022

Revolution Consulting

Introduction

This is the third annual collection of evidence that is available in relation to the financial performance of the largest independent sector children's social care provider organisations operating in England. In this report reference to the independent sector includes both private companies and voluntary sector bodies.

The first report in this series was published in January 2020 and covered the largest 16 groups of providers. In 2021 the study was expanded to the largest 20 groups and was updated in two tranches reported in December 2020 and May 2021 to capture information reported later than the normal annual cycle by provider organisations due to temporary relief from filing deadlines related to Covid. This year sees a return to normal reporting timescales and again covers the largest 20 providers.

The work is commissioned by the Local Government Association (LGA) and seeks to identify the profitability of the largest independent children's social care providers in England, and to identify indicators of debt risk in those organisations. The work does not look specifically at independent special schools, providers of support services or other organisations supporting children and young people, except to the extent that such services are part of larger groups where fostering and children's homes are a substantial part. The method statement in Appendix 1 describes the sample selection criteria more fully.

The predominant source of information for the study is Companies House where, subject to Companies Act 2006 requirements, most of the provider organisations file financial statements for historical periods.

Those statements are prepared to UK and international accounting standards and are independently audited.

Whilst there are technical accountancy issues that need to be understood to perform the analysis, wherever possible this report is written assuming the reader is not a qualified accountant or finance professional. Some technical terms are unavoidable, but explanations of such terms used are provided, and interpretation of the results seeks to use non-technical language.

Copyright statement

Summary of results

The information available to this year's study gives a comprehensive insight to the impact of Covid-19 on the providers of children's social care services. Although provider reporting periods vary, the annual accounts of providers that form the basis of this study cover from late 2019, all the way through 2020 and into the first half of 2021, during which time the first waves of infections and lockdowns were experienced.

After a period of uncertainty as the first lockdown of Spring 2020 took effect, the sector is reporting only limited overall financial impact of Covid-19 and has largely returned to the trends observed before the pandemic.

Total reported spending on residential care and fostering by local authorities in England with the independent sector grew to £2,262 million in 2020/21 (an increase of 11% in the last year). This has been led by annual residential care spending growth of 17% combined with lower fostering growth of 3% for the year.

The income of the largest twenty provider organisations is **£1,685 million** (an increase of 8% on the previous year), indicating that it is not only with the largest providers where councils increased spending. The income includes fostering, children's homes, and other social care services including residential school places and leaving care.

Aggregate profits measured using the EBITDA method (Earnings before Interest, Depreciation and Amortisation) amount to **£333 million** at an EBITDA margin of **19.8%** (up from 18.8% in the 2021 study on a like-for like basis). Aggregate profits for the whole sample were therefore 14.2% higher than the previous year.

In their recently published final report, the Competition and Market's Authority have restated their view that profit levels of large providers are higher than would be expected in a well-functioning market. The CMA have therefore made a series of recommendations for Governments in relation to commissioning.

At an individual provider level results vary significantly with different providers at different stages of their growth and investment strategies. The largest four providers continue to represent almost 60% of the sample, but growth rates are highest amongst the second tier of operators.

Private Equity ownership amongst the largest providers is increasingly prevalent. Ten of the twenty largest providers (50%) have PE ownership, and this proportion increases to eight of the largest ten (80%).

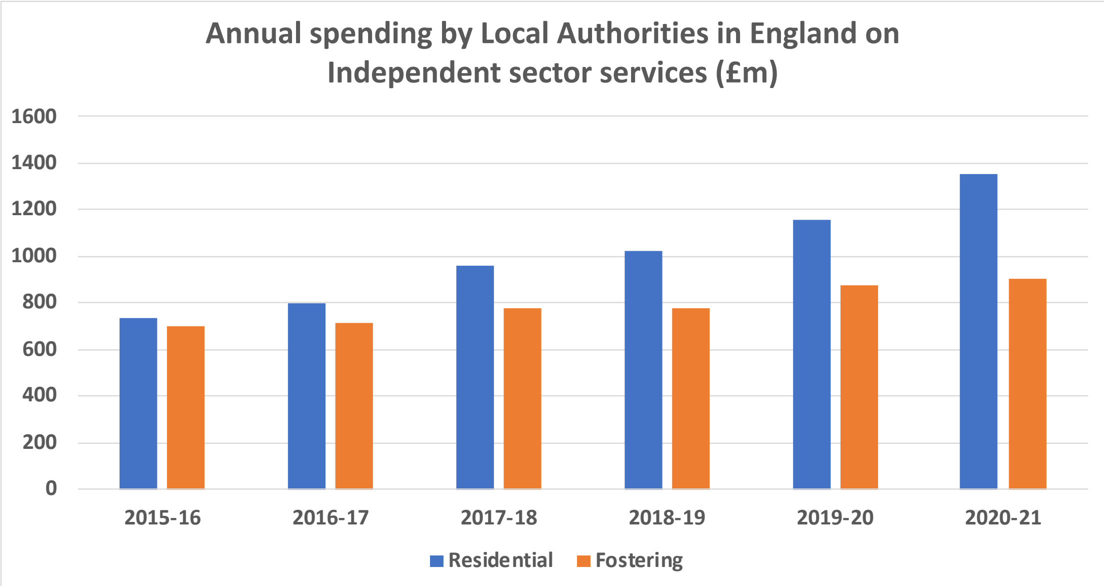
After a reduction in corporate level activity from the spring of 2020 when Covid first struck, acquisitions, changes in ownership and refinancing activities picked up again later in the year, returning close to pre-pandemic levels by the end of the study period. The continued income and profit growth amongst a large majority of the providers helped to fuel this activity and to support increases in debt levels where additional finance was sought.

No substantial failures or disorderly exits were experienced by the sector during the period of study, and there is increased evidence disclosed in accounts about the way that providers and those that finance them monitor the debt levels and risk. This existing monitoring has potential application in the statutory oversight regime proposed by the CMA.

The sample and representativeness

This study is particularly concerned with the services that local authorities purchase from social care budgets. The fostering and children's homes sectors are therefore the primary target areas. These are also the sectors where local authority children's social care budgets have reported the highest levels of overspending in recent years.

Reported spending by local authorities on these elements of children's services and where there is significant outsourcing to the independent sector is illustrated below.[1]



Total reported spending on residential care and fostering with the independent sector across the period of this study has grown to £2,262 million (an increase of 57% since 2015/16 and 11% in the last year). This has been led by residential care spending growth of 84% across the whole period (17% in the last year) and by lower fostering growth of 29% for the period (3% for the year). In addition to these areas of spending, councils also spend on placements for older children in supported accommodation and on placements in SEN/Special schools in the non-maintained and independent sectors from social care budgets.

The rate of growth of spending is considerably higher than the growth in overall demand levels (for example the number of children looked after grew 15% across the period, and 1% in the last year). This indicates higher levels of use of purchased fostering and residential services at increased average prices.

The total annual fee income for children's services of all types for the twenty groups included in this update study is £1,685 million (an increase of 8% on the previous year). This aggregate income includes income for special schools' services that may be funded from non-social care budgets, also for leaving care and supported living services and services provided to local authorities outside of England. Hence the aggregate income of the sampled providers is not directly comparable to England-only spending reported by councils (represented in the chart above) but provides a useful indicator of relative scale.

[1] https://explore-education-statistics.service.gov.uk/find-statistics/la-and-school-expenditure

As described in the method statement in Appendix 1, an important source of information to select the sample of provider groups for this study comes from Ofsted, and their published data on the makeup of the provider sector.[2] This data provides further information as to the scale of the larger providers relative to the whole sector. Ofsted particularly highlight (as of 31 March 2021):

- The private sector in general, including the largest private operators have continued to invest and grow.

- The top 10 companies accounted for 33% of all children's homes, with the largest, Caretech, accounting for almost 10% of all private homes.

- The top 21 companies own 38% of all private children's homes.

- The 7 largest providers of fostering services account for 61% of all private sector places, with the largest, (Outcomes First Group), accounting for 18% of all private sector IFA places.

- Four companies appear on the list of largest providers of children's homes and IFAs. These are: Caretech, Outcomes First, Polaris and Compass. (All feature in the sample in this study).

The sample selected for this report is listed in Appendix 2, identifying the legal entities studied and their ownership. In summary the ownership status is:

- 50% (10 out of 20) have a majority or minority private equity owner (up 2 on last year).

- Caretech is the only stock market listed group (down 1 on last year due to Priory sale to Waterland).

- Three have charitable status.

- Six remain in private hands without recognised private equity backing, with a variety of constitution including a social enterprise and an employee ownership trust.

The most recent annual spending data summarised above, and the Ofsted information referred to is measured for the year to 31 March 2021, or as of 31 March 2021. The providers in the study sample do not all report to the same timeline. The provider reporting periods covered by this report are shown in Appendix 2, the majority overlapping the calendar 2020 year, or the year to 31 March 2021.

[2] https://www.gov.uk/government/publications/inspection-outcomes-of-the-largest-childrens-social-care-providers/largest-national-providers-of-private-and-voluntary-social-care-march-2021

Income and Profitability

Fee income (or "turnover") reported in the published financial statements of provider organisations gives the clearest indication of the level of purchasing of services by local authorities with each sampled provider. With no significant private-individual funding for the services covered by this research, the income of providers is almost exclusively derived from fees invoiced to councils for placements with providers.

The ability of the operations of each provider to deliver their services and to yield a profit or surplus out of the income is of fundamental importance to the sustainability of the providers, to their future investment in quality and growth, and (in the private sector) to their ability to distribute returns to owners. As discussed in Appendix 1 we use EBITDA as the measure to examine the financial performance of the providers in this study.

The results for both measures (income and profitability as measured by EBITDA) are set out in the table below for each provider and in aggregate. The providers are listed in column 1.

To provide a degree of comparability between providers and to estimate the total annual activity of the sample in aggregate, we have used calculations of annualised absolute income/turnover (column 2) and annualised profit/EBITDA (column 4), highlighted in orange. More detail of the method of calculation involved in arriving at those figures are set out in Appendix 1.

Profitability is also expressed as a percentage of the income level; this is usually referred to as the profit or EBITDA "margin" (column 5).

Columns 3 and 6 are trend indicator calculations, showing the growth (or decline) in income compared to the previous annualised period in column 3, and the growth or decline in absolute annualised EBITDA profit in column 6.

Aggregates for the whole sample are shown in the totals at the foot of each column along with the mixed average growth rates and margin percentage.

Fee income and profitability measures and trends for the largest children's social care providers – March 2022.

	Provider		Annualised Children's Services Income £	Annual growth in Income		Annualised EBITDA £	EBITDA margin as a % of Income	Annual EBITDA growth
1	Outcomes First		364,676,096	5.2%		71,499,745	19.6%	0.3%
2	Caretech		306,759,000	4.4%		83,883,000	27.3%	13.5%
3	Polaris		181,970,672	2.7%		37,510,062	20.6%	28.5%
4	Priory		147,571,000	3.3%		41,208,000	27.9%	8.3%
5	Keys		110,722,385	10.8%		24,152,881	21.8%	62.9%
6	Witherslack		95,426,655	27.1%		22,987,450	24.1%	62.0%
7	Compass		81,537,526	13.9%		11,568,102	14.2%	14.3%
8	BSN Social Care		52,469,618	13.7%		2,224,310	4.2%	-72.7%
9	Horizon		52,052,035	37.8%		8,315,586	16.0%	44.4%
10	Five Rivers		50,065,896	13.8%		3,412,143	6.8%	-10.5%
11	Capstone		32,688,392	-3.8%		4,886,663	14.9%	10.4%
12	Together Trust		30,455,000	3.1%		2,203,000	7.2%	15.3%
13	Hexagon		30,431,200	10.1%		5,327,199	17.5%	14.5%
14	Esland		30,394,259	49.3%		5,444,864	17.9%	41.9%
15	TACT		25,597,000	-15.8%		2,131,000	8.3%	704.2%
16	Sandcastle		19,397,775	60.2%		1,875,216	9.7%	-29.6%
17	Care 4 Children		18,957,570	8.5%		4,371,747	23.1%	3.0%
18	Sunbeam		18,673,145	5.8%		1,075,787	5.8%	-21.2%
19	SWIIS		17,859,347	4.3%		183,680	1.0%	-139.4%
20	Homes 2 Inspire		16,886,000	15.7%		-1,006,000	-6.0%	179.4%
	TOTAL		1,684,590,571	8.3%		333,254,435	19.8%	14.2%

Observations and comments:

A. The total income for the sample is **£1,685 million**. This represents an 8.3% increase in a year. That is below the 11% increase in spending of local authorities discussed above, which would suggest that other parts of the sector grew at a higher rate.

B. There is wide variation in growth rate at the individual provider level, ranging from 60% growth at Sandcastle due to rapid opening if new homes combined with acquisition activity, to a 16% decline at TACT due to exit from a contract with Peterborough City Council.

   All but two of the providers exhibited growth in the latest period, however this illustrates that, even in a growth sector, each operator can perform differently based on their resources, strategy and positioning.

   The largest four providers make up 60% of the income of the total sample, but their growth was more modest (between 2.7% - 5.2%) than for the rest of the sample, where stronger growth rates are particularly evident amongst the second tier of providers. This is again a function of both organic growth (including new openings of homes and education facilities) and acquisitions of smaller providers.

C. The total profit/EBITDA for the sample is **£333 million**, and this represents a profit margin of **19.8%** in aggregate (vs 18.8% in the previous study on a like-for-like basis). Aggregate profits for the whole sample were 14.2% higher than the previous year because of the overall increase in profit margin reported.

   Efficiency and economy of scale again appears to be a factor, with the higher profit margins tending to be reported by most of the largest groups.

   Some caution in interpreting this is advised as some of the EBITDA margins reported by the large providers do not take into account central or underlying costs of the larger group of which they are a part (e.g. Caretech and Priory). This has the effect of increasing the EBITDA margins they report at the operational services level.

   The overall uplift in EBITDA margin would also suggest that occupancy rates and efficiency of operators improved year on year. This would be consistent with the high demand levels reported by local authorities.

D. The relative share of the whole sample represented by the largest, and next-largest group of providers was little changed on last year. The relative proportions are shown in the chart below.

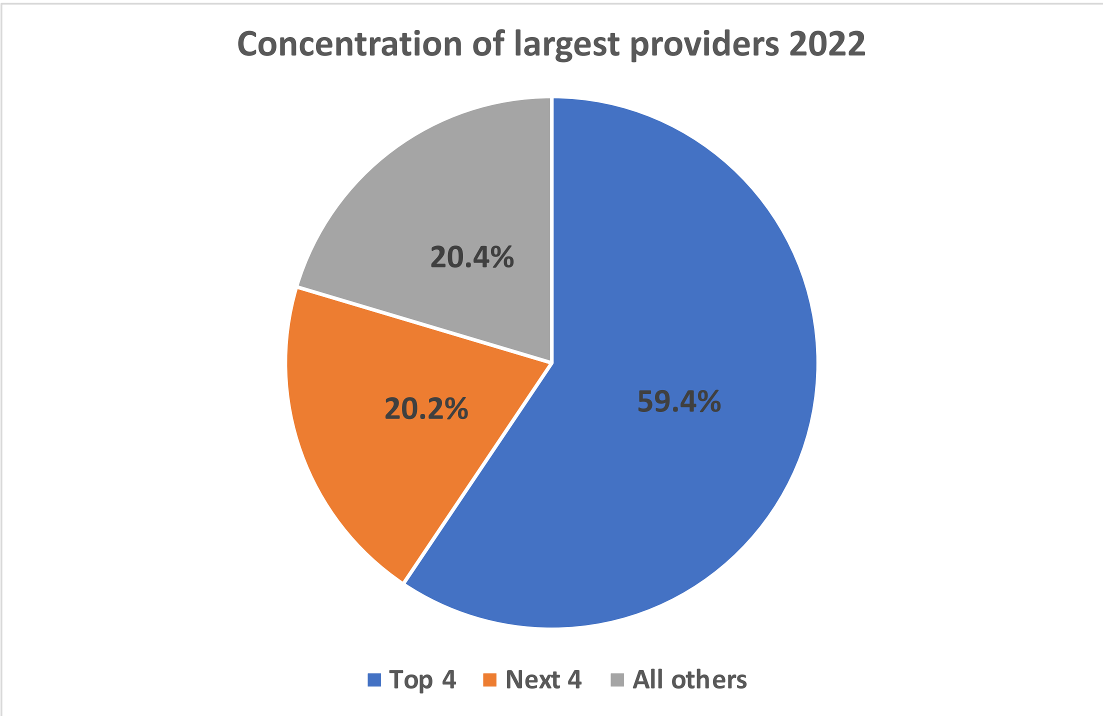
E. Eight of the largest nine groups have private equity ownership involvement, and the other Caretech, is stock market listed.

F. It should again be stated that the profit levels reported by smaller providers outside of this sample group is usually at materially lower levels (absolute and margin %). Surveys of members of the Independent Children's Homes Association by Revolution Consulting confirm this for children's homes services.

G. Loss making would generally be an early indicator of solvency or sustainability issues for an organisation. In this update study the only loss-making organisation is Homes 2 Inspire who are investing in new long-term contracts and capacity. A relatively small part of the overall operations of the Shaw Trust, the children's services continue to have the Trust's support.

H. Acquisitions by larger providers of smaller operators continued during the year, albeit with some indication of lower levels of activity due to the uncertainties around Covid in 2020. A full list of activity reported in the accounts of providers, and the trend in numbers of corporate transactions is shown in Appendix 3.

I. The Competition and Markets Authority, in the final report from their 2021/22 study of the children's social care sector, have reached a conclusion that prices and profit levels of providers are at a higher level than would be consistent with a well-functioning market. The CMA have put forward a range of recommendations as to how to improve the functioning of the sector including a role for larger scale market engagement and national support for forecasting, market shaping and procurement.



Largely stable ratios with higher growth rate of the second tier (compared to the largest four providers) producing a marginal increase in the share they represent (20.2% vs 19.9% last time).

Sustainability and Solvency risk indicators

The indicators used in these studies to give insight to debt and solvency issues are described more fully in Appendix 1 and are unchanged from previous studies. The table on the following page includes the results for these indicators for all providers in the sample, where information is available to perform the calculations.

The providers are again listed in column 1.

Columns 2 and 3 are derived from the balance sheet of the provider and indicate if, at the balance sheet date, the provider is reporting net assets or net liabilities. The second indicator excludes intangible assets (e.g., goodwill) from the calculation.

Column 4 gives a trend indicator by comparing the two balance sheet indicators to the previous report.

Fundamentally these measures give indication if the provider has enough assets with which to meet its liabilities as at the balance sheet date. A negative measure requires further investigation into the relative timing of future transactions to judge if the provider has a reasonable expectation of being able to meet its liabilities as they become due.

Absolute values for liabilities and debt from the balance sheet are of limited value alone and need to be related to the ability of the underlying business to pay off the interest and principal amounts of the loans.

Columns 5 and 6 of the table below offer two straightforward indicators to begin to test the manageability of external debt. The two indicators are defined in Appendix 1. These indicators test if the operating profits of the provider are sufficient to at least pay the interest that is coming due on the external debt alone (interest cover) and, secondly, how many years of EBITDA would be needed to pay off the underlying external loans.

As a rule of thumb, interest cover (column 5) calculated this way would ideally need to be above 1.0. The number of years to repay debt (column 6) gives an initial insight into how indebted the group is. A high figure suggests the need to investigate further the timing of the scheduled repayments of that debt and to assess the ability of the provider to make those repayments. Such information is not always fully available in the statutory financial statements of providers.

Column 7 provides a trend indicator for these two solvency indicators by comparison to the previous year's study.

As discussed in Appendix 1 it is critical to be able to access the full funding picture from the top level of the consolidated group in which the children's services sits to assess solvency issues.

The reason for the focus the external/bank debts is that they are more likely to require fixed repayment of interest and debt capital and, if defaulted against, may grant the bank or other lender rights to step in and assume control of the provider operations. Bank debt is therefore generally monitored ahead of other debts loaned by the shareholders/owners who often do not require repayment until later dates or when the business is sold. Shareholder loans and other financing are discussed in more detail in the following section of this report.

Solvency and debt measures for the largest children's social care providers – March 2022.

	Provider		Net Assets/(Liabilities) £	Net Tangible Assets/(Liabilities)	Trend		Interest Cover (External Debt)	Years to repay external debt	Trend
1	Outcomes First		(232,695,000)	(553,090,000)	--		1.9	7.2	+-
2	Caretech		380,917,000	207,019,000	++		9.7	2.5	++
3	Polaris		51,996,000	(101,236,000)	++		4.1	2.7	++
4	Priory		NA	NA			NA	NA	
5	Keys		(46,121,000)	(120,523,000)	--		3.5	5.1	++
6	Witherslack		NA	NA			NA	NA	
7	Compass		(10,019,963)	(60,698,923)	-+		4.1	3.8	++
8	BSN Social Care		216,826	(88,602,170)	--		0.3	*Note 1	-
9	Horizon		18,546,369	(45,426,856)			2.2	6.7	
10	Five Rivers		11,699,835	9,552,327	++		199.1	NApp	+
11	Capstone		9,908,809	(5,607,646)	++		21.7	1.0	++
12	Together Trust		27,093,000	27,093,000	++		43.2	NApp	+
13	Hexagon		9,294,573	8,777,811	++		21.5	0.2	++
14	Esland		(9,126,183)	(37,272,405)	--		2.3	6.0	++
15	TACT		4,869,000	4,869,000	++		NApp	NApp	+
16	Sandcastle		13,867,323	(1,220,304)	--		0.8	18.1	--
17	Care 4 Children		7,122,504	6,314,054	++		12.0	0.7	--
18	Sunbeam		6,626,577	6,626,577	++		*Note 2	0.8	-
19	SWIIS		3,410,767	3,410,767	++		24.2	NApp	++
20	Homes 2 Inspire		82,889,000	68,597,000	++		18.7	NApp	+

Note 1 – On 2 March 2021 the Lindale group was sold to Orange Cloud Topco Limited. The pro-rata results used in this study are for a short period to 31 March 2021 and therefore should be treated with caution. The balance sheet of Orange Cloud reports loan notes of £92,094,885 but the accounts do not disclose the loan note holders. In September 2021 the group repaid £20m of those loan notes (plus interest) and new bank financing was acquired on the same date. Further consideration of the appropriateness of indicators will be made when future results are made available.

Note 2 – No net interest payable.

Observations and comments:

A. As highlighted in previous studies, visibility of the impact of the financing arrangements used in recent acquisition activities may not be available until the publication of full accounts of the new parent group. There can therefore be a period when it is not possible to apply the solvency indictor approach, and this is particularly the case in this study where:

Priory Group acquired by Waterland and divested into Aspris, August 2021

Mubadala Capital acquired a stake in Witherslack, August 2021.

MML Capital Europe acquired a stake in BSN Social Care March 2021 (see note 1 above)

B. Four of the providers reported negative net assets in this study period (last year also four), and that number increases to nine (six last year) if intangible assets are excluded. All except Capstone (now owned by an Employee Ownership Trust) have private equity ownership.

   More than half of the sample (60%) report improved balance sheet positions compared to last year. This is related to the increased profit performance of 90% of the sample reported in the previous section.

   In some cases that increased profit has also allowed the providers to borrow more to finance further acquisitions and to restructure some of the existing borrowings. The result is an increase in net liabilities of some of the sample.

C. The results of the interest cover and years to repay external debt indicators vary widely, but, with limited exceptions, the trend is one of improvement in these indicators for a majority of the sample compared to a year earlier.

   The highest levels of interest cover relate to the voluntary sector and private individual owned providers. The lowest number of years indicated to repay external debt is also demonstrated by these providers. Several of this set of providers have no, or negligible external debt (indicated by "Not Applicable" NApp in column 6).

   Providers with private equity ownership involvement tend to demonstrate the impact of the external funding mechanisms typically employed by those owners. Interest cover is typically in the lower range, but still above the benchmark 1.0 level, and years to repay debt is typically in in 3-7-year range.

   There are two instances where the interest cover indicator is lower than 1.0. One of these, Sandcastle, also returns the highest calculation of years to repay. BSN is discussed in note 1 above and these results must be treated with caution. For both BSN and Sandcastle measurements were made soon after a recent change in financing structure so a whole year of trading against which the debt servicing can be measured is not yet possible.

   The ways in which the providers, their owners and funders, and their auditors assess the risk of debt is further considered in the following section.

D. Whilst the debt levels of some providers are substantial in actual terms the sector has not experienced any corporate failures during the period of study.

E. In their final report the CMA have recommended a formal statutory oversight regime and requirements for robust contingency planning on the larger providers.

Corporate activity, Private Equity, Debt Management (Going Concern), and value extraction

This years' update has again detected a changing ownership landscape amongst the 20 provider groups studied, and, once Covid related uncertainties were reduced, a return to acquisition activity in the sector (see Appendix 3), often funded by increased borrowing by the financial investment sector.

The increased revenues of the larger providers and increased overall profitability is likely to be making a significant contribution to the willingness of the financial sector to invest. Once again, we have seen that, despite some significant levels of debt around the sector, providers appear to be managing the burden of interest and loan repayments with the aid of the profitable cashflow from the underlying operations.

As discussed in earlier reports, operators are monitored by those who fund their activities in the financial sector, and the reporting studied this year found increasing detail of the kinds of activity being undertaken to test the solvency and sustainability of the providers.

One way in which this is disclosed is through the requirement for published financial statements to discuss the justification as to why the accounts are prepared on the assumption that the business will be able to continue to operate beyond the balance sheet date (despite sometimes showing liabilities that significantly outweigh assets). This "going concern" basis must be justified to external auditors who are charged with the responsibility of commenting specifically on the appropriateness of the going concern assumption.

As the largest provider, with private equity ownership, and utilising the typical debt financed acquisitions strategy, the Outcomes First Group provides insight to the work it performs to monitor and manage its debt position. The below is taken from the latest accounts:

Going concern

The Group meets its day to day working capital requirements through its long-term bank facilities. The directors believe that it is appropriate to prepare the financial statements on a going concern basis, the board having considered the following in particular:

• The Group has net current assets of £21.8m (2019: net current assets of £3.2m).

• The Group has total net liabilities of £232.7m (2019: £152.1m). Bank loans amounting to £510.0m were refinanced in the year ending 31 August 2019 and are repayable in full on 18 July 2025.

• The Group recorded a loss of £78.4m (2019: £57.1m) for the year under review, after reflecting non-cash interest costs of £33.7m (2019: £28.1m) and amortisation of intangibles amounting to £52.9m (2019: £43.1m).

The Group generated an operating cash inflow in the year under review of £0.9m (2019: £7.5m inflow), net of cash interest costs of £38.1m (2019: £41.6m) and at 31 August 2020 held cash balances amounting to £6.3m (2018: £15.2m). The decrease in operating cash flow in the year, despite an increase in underlying results, is attributed to short term timing differences on payments from local authorities as a result of changes to internal processes which are expected to rectify in the 12 months following year end.

Cash balances are retained within the business to support future development plans such as improvement and expansion spend on its schools, offices, foster parent training facilities and residential care homes. The Group also has access to a revolving credit facility of £10m which was partially drawn at year end.

The underlying trading performance of the business is strong, further supported by the acquisitions of fostering agencies and an increase in education and residential care occupancy. In July 2020 a detailed annual budget for the year to 31 August 2021 was produced. This, together with business modelling and financial forecasts for a further two years, predicts further growth. This budget and the forecasts were thoroughly reviewed and approved by the Board and also provided to the lenders of the senior loan facilities. Detailed forecasts were prepared, showing that there is sufficient cash headroom for the Group to meet its liabilities as they fall due and that all covenant requirements under the loan arrangement will be met in the foreseeable future and, accordingly, they have determined it is appropriate to prepare the financial statements on a going concern basis.

COVID-19 pandemic has resulted in significant disruptions in global economic activities, though the impact on the business is currently limited. The Group has been able to maintain normal operations within the guidelines of governmental requirements and while keeping the safety of its employees in mind.

While the scale and duration, as well as the impact of COVID-19, remain uncertain, Management is of the opinion that the Group's cash flows from operations will continue to provide the cash necessary to satisfy the Group's working capital requirements for twelve months from the date of approval and signing of the financial statements by the directors.

The note highlights the large net liabilities of group, but also indicates that the underlying cashflow is sufficient to pay the interest due on loans. Further, the group has provided forward modelling for up to three years to its primary lenders to demonstrate that covenant tests in the loan contracts with those lenders will not be breached.

PricewaterhouseCoopers, the group's auditors, further state:

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's and parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and parent company's ability to continue as a going concern.

Other provider accounts take a similar approach, including downside scenario planning and reverse stress tests to test the solvency of the organisation if it experienced reductions of revenue (Brexit, Covid, price reductions or other reason), site closures, unanticipated wage and other cost inflation and even cyberattack (Caretech).

The CMA's final report confirms their conclusions that the debt levels in the sector could lead to disorderly exits and leads to their recommendation that a statutory oversight regime should be introduced. Clearly, the monitoring of debts outlined above that already takes place at a provider and lender level by has the potential to contribute to the debt management picture in the sector.

In this environment of closely monitored cashflows, as in previous reports, there was no evidence of extraction of value via dividends by private equity owners in this most recent period of ownership of the operator, and while also carrying debts due to third parties. Some monitoring fees were paid and disclosed to owners in the accounts.

The primary method of private equity obtaining a return on investment from the ownership of these provider organisations comes from the onward sale of the organisation, or from refinancing.

Appendix 1

Method and technical descriptions

1. Local authority spending data (section 251 return based) was accessed to describe the level of spending on foster care and residential children's services as reported to the Department for Education by local authorities in England. Ofsted reporting in relation to the largest providers of services was also used to illustrate the representativeness of the sample of providers in this update.

2. The largest provider organisations were identified utilising a model that was primarily based on data provided by Ofsted in relation to the capacity of children's homes and fostering agency organisations operating registered services.

The selection model applies estimated average income per unit of capacity to rank providers by a calculated national financial income capacity.

Ofsted also provide a list of the top 21 private children's homes, the top 5 voluntary sector children's homes and the largest 16 IFAs against which the model outcome can be benchmarked.[3]

The Competition and Markets Authority have also been engaged in a market study in 2021/22 and have listed the largest 15 children's social care providers in their interim report, providing a further benchmark.[4][5]

Where available the accounts of candidates for selection are accessed to examine revenue levels and to compare to revenues reported by the previous studies.

Taken together, these activities allow the selection of the largest 20 provider groups based on their revenue levels from children's services and fostering.

LGA also reviewed the final list of selected providers to confirm that the expected organisations were present in the sample.

3. The latest available audited public accounts of the identified providers were downloaded from Companies House for the sample of providers between 21 December 2021 and 15 February 2022.

4. In relation to acquisitions made after the reported accounting period, a change in method was applied in this study compared to earlier reports. Previously it has been possible to access useful information from the accounts of the acquired entity and to use these to estimate the annual revenues that the acquisition will make to the acquiror's group. For this study there were several potentially material acquisitions identified where the statutory accounts do not contain the required detail to make a reliable estimate. Future group accounts of the acquiror group will show the impact in due course.

---

[3] https://www.gov.uk/government/publications/inspection-outcomes-of-the-largest-childrens-social-care-providers/largest-national-providers-of-private-and-voluntary-social-care-march-2021

[4] https://www.gov.uk/government/publications/childrens-social-care-market-study-interim-report

[5] As an illustration of benchmarking, this study includes 13 of the 15 groups studied by the CMA. The two exclusions are Care Visions (a provider operating primarily in Scotland) and the partnership of Care Today (constituted as a partnership and for which statutory accounts are not available in the public domain)

Where this change in method has a material impact on comparisons to the the previous report period we have amended the comparative figures so as to make comparisons on a like for like basis.

5. Key information and indicators from the downloaded financial statements (see details in Appendix 2) were extracted.

The information extracted included turnover, operating profits, financing costs, data required to calculate EBITDA, external funding levels and terms, solvency indicators and data to calculate the same. Technical descriptions of data and calculations follow in this Appendix below.

6. Results were screened to identify providers where the separation of results of fostering vs children's homes vs other services can be achieved. The availability of such analysis was again severely limited to just 2 of the organisations and is not therefore reported in this study. Results presented in this report are therefore a mixed or blended aggregate of each provider's children's services combined.

7. To normalize results to an annual measure, adjustments to reported results are made in several ways to produce the analysis presented in this report. It is also important to use only meaningful balance sheet information for the solvency indicators, and that information exists for some of the groups studied at a higher parent or holding company level than the entity or subgroup where operations results are reported. For example:

- Periods of reporting that differ from 365 days are adapted on a pro-rata basis to produce annual estimates.

- Part year acquisitions disclosed in parent group accounts are similarly estimated to a pro-rata annual equivalent.

- Most of the provider groups in this study are solely engaged in children's services and hence the whole result of the parent group is used in this report. However, for some the children's services results are only part of the results of the wider group and are extracted from those of the larger groups in different ways. For this study the following specifics are relevant:

  Caretech provide segmental data in their reporting allowing children's services to be separated from adult services. Solvency is assessed at the full group level.

  Priory children's services performance is extracted from the Priory Group UK 1 Limited accounts that also provide a segmental analysis. Solvency related information will only become visible once the newly formed children's services group (Aspris) begins to report results in the UK.

  Witherslack has undergone a change of ownership with Mubadala Capital making an investment. The solvency of the newly owned group will only become visible when future filings are made.

  By contrast the acquisition of the Horizon group by Graphite in 2019 meant that last year's study had no published balance sheet information for the newly formed group and therefore solvency could not be assessed. The new group has now reported results so this study can

again look at solvency indicators based on new ownership and debt levels.

SWIIS Foster Care results are from the operations of the company in England, the results of a separate Scotland based operation are not included. However, solvency information can only be meaningfully taken from the parent SWIIS International entity.

Homes 2 Inspire children's services performance is accessed via the entity bearing that name, but solvency data is accessed via the Shaw Trust parent entity.

8. **Profitability – what to measure?**

There are several different measures of profitability, each with its own purpose. Audited financial statements include several measures of profit in the published Profit and Loss Account statement (one of the key sources of information in any set of accounts).

The different profit measures used are essentially different from one another based on what they include and exclude from the calculations.

Some of the key differentiators are related to the inclusion or exclusion of:

- Corporate Taxes where these are payable (primarily in the private sector).
- Interest receivable and interest payable (this relates to the financing structure of the business).

These are not the only differentiators.

If the purpose of examining profitability is to obtain an understanding and insight to the profitability of the underlying trading or operations of an organisation, then there are additional profit measures that can be derived from the information disclosed in accounts. Some larger providers sometimes disclose this calculation in their own accounts, and we seek to use that calculation where possible.

This report seeks to examine that underlying trading picture as a key objective.

The financial accounts of a provider include all or most of the costs of providing the service in addition to the income levels. It is therefore possible to gain some indication of what level of profit is earned from the fees received using the accounts information.

The measure used in this study seeks to remove the "noise" of non-trading items from the profit measure it uses.

The measure is:

EBITDA = Earnings before Interest, Tax, Depreciation and Amortisation

The elimination of depreciation and amortisation removes accounting complexities related to what are essentially capital transactions. Whilst not unimportant, they are often removed when just the underlying annual trading position is being examined.

This measure is also widely used in financial analysis and is used extensively by the investment industry. Where a provider self-calculates and discloses EBITDA the provider's own measure is used in this study. In addition, these calculations often seek to eliminate any exceptional, non-recurring costs from the EBITDA measure to illustrate the true underlying result of the operational performance. Such further adjustments may include one-off integration costs following a large acquisition, or exceptional one-off adjustments for example in relation to a large asset sale.
Most providers do not however self-disclose the calculation, so it is derived and calculated from figures extracted from the accounts of those providers using the formula above.

Some of the non-recurring items that are excluded to calculate EBITDA are potentially subjective and may require further information that is not included in the published accounts. We would again invite any provider group representatives to contact us is they would like to clarify or suggest changes as to how the calculations are made.

Some financial analyses go further in also looking to eliminate rental costs of property, but this study has not taken that further step. Several providers report sizeable operating lease costs, often in relation to rental of property used by the provider. These costs raise the possibility that and profit or loss on renting property to the operating business is not included in the reporting we have accessed.
It remains a possibility to extend this type of study in a way to examine this factor further.

9. **Solvency and sustainability – what to measure?**

Solvency of a business is essentially related to an organisation's ability to generate cash and thereby to be able to pay its bills as they become due.

Without that ability an organisation's survival becomes increasingly dependent on the willingness of those who are owed money to support the organisation while it goes about raising enough money to settle its liabilities.

If those parties owned monies lose confidence in the ability of the business to repay the sums due then it can lead to sale, liquidation, and cessation of the business altogether.

Some organisations are heavily dependent upon the continued support of the owners and funders of the business to remain sustainable in the short and medium term.

Measures used in this study look at both balance sheet measures of solvency and at the relationship of cash generated by the operational trade of the business to the requirement to pay interest and capital amounts back to funders.

As indicated above, where the children's services operations of a group are only part of the activity of the wider organisation, or where funding comes from a parent group then the solvency indicators used are those of the group, as any subsidiary level analysis is relatively meaningless.

Solvency and Sustainability indicators

Balance Sheet Total Net Assets/(Liabilities) – fundamentally, does the business have more assets than liabilities as at the balance sheet date?

Net Tangible Assets/(Liabilities) – More of an acid test that assumes intangible assets such as the goodwill accounted for at acquisition of a business has zero value (e.g., in a winding-up process).

Interest Cover: (EBITDA: Interest Paid ratio) – Asks the question as to how easily the current operations can at least pay interest on borrowings as it becomes due for actual payment.

Years to pay bank debt – How many years would it take for current levels of trading to generate enough cash to pay off money due to third party banks/funders only (typically those with security over the business assets and the right to step in and liquidate if necessary)?

Appendix 2

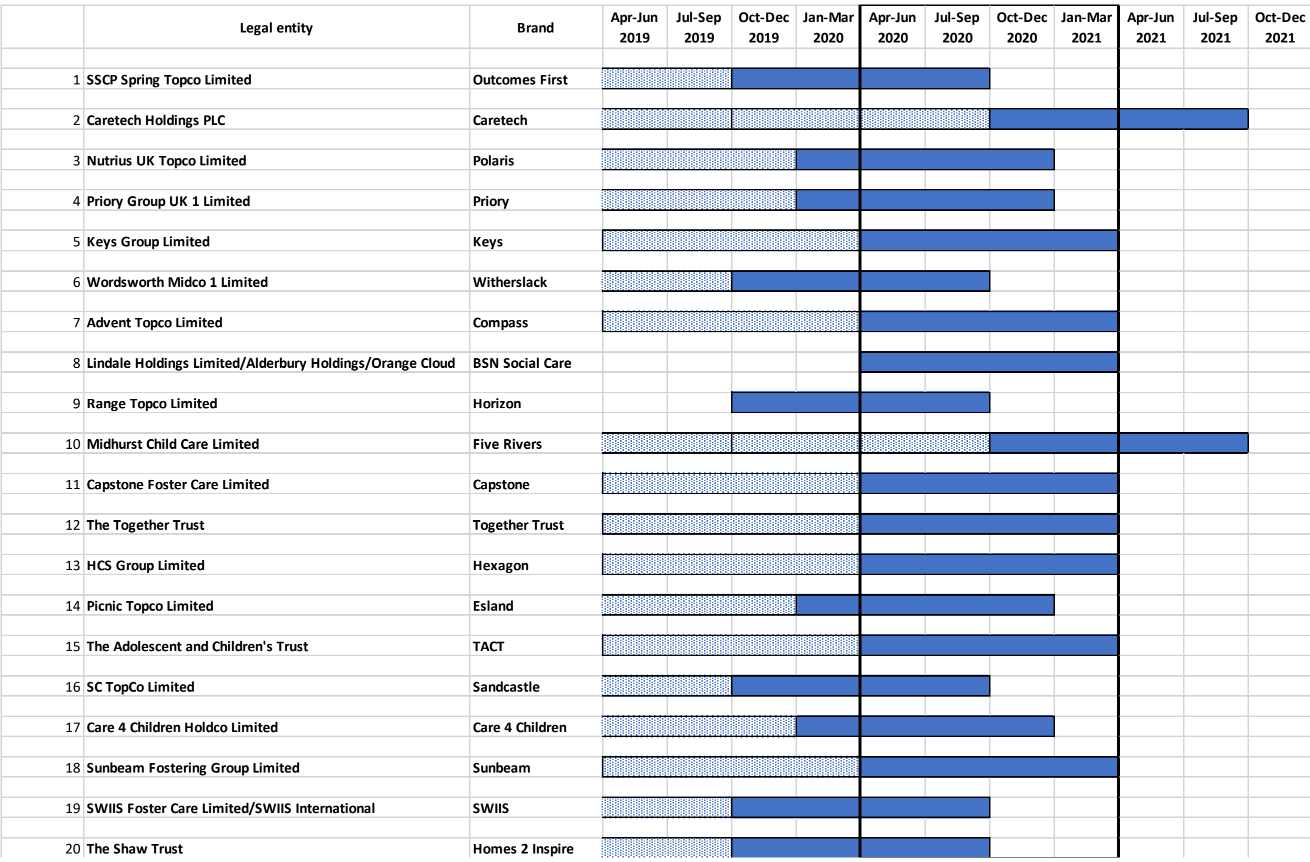
Ownership, entities, and reporting periods

Group name in this study	Group entity(ies) accounts studied	Entity number(s) (Companies House number)	Ultimate ownership controlling party	PE involvement?
Outcomes First Group	SSCP Spring Topco Limited	09248650	SSCP Spring Holdings SCA (Luxembourg) is the ultimate parent undertaking. Funds managed by Stirling Square Capital Partners Jersey AIFM Limited are the ultimate controlling parties.	Yes
Caretech	Caretech Holdings PLC	04457287	Shareholders – shares traded on London Stock Exchange (AIM)	No
Polaris	Nutrius UK TOPCO Limited	11598370	CapVest Equity Partners III LP	Yes
Priory	Priory Group UK 1 Limited (Education and Care divested to Aspris Holdco Ltd 31 August 2021)	09057543	Acadia Healthcare Company Inc. (US) until 19 Jan 2021 Waterland Private Equity Fund VII CV (as both part of Priory from 19 Jan 2021 and since divestment into Aspris 31 Aug 2021)	Yes
Keys Group	Keys Group Limited	10625350	G Square Healthcare Private Equity LLP	Yes
Witherslack	Wordsworth Midco 1 Limited	10923566	Mubadala Capital (from Aug 2021) Livingbridge Charme Capital Partners	Yes
Compass Group	Advent Topco Limited	11053915	A1 ordinary shares are held by funds managed by Graphite Capital. No individual holds more than 20%.	Yes
BSN Social Care	Orange Cloud Topco Limited	13044988	MML Capital Europe (Luxembourg) has significant control but in the opinion of the directors there is no ultimate controlling party.	Yes

Five Rivers	Midhurst Child Care Limited	05657414	P J McConnell	No
Horizon	Range Topco Limited	12135972	B ordinary shares are held by individuals and funds managed by Graphite Capital. No individual holds more than 20%.	Yes
TACT	The Adolescent and Children's Trust	2779751 Charity 1018963 Charity Scotland SC039052	Members/Trustees	No
Capstone	Capstone Foster care Limited	06128293	Capstone Employee Ownership Trust (from December 2020)	No
Together Trust	The Together Trust	301722 Charity 209872	Members/Trustees	No
Esland/Oracle	Picnic Topco Limited	11732793	August Equity IV GP Limited (company based in Scotland) No single ultimate controlling party.	Yes
Hexagon	HCS Group Limited	11241666	M. Bell	No
SWIIS	SWIIS Foster Care Limited SWIIS Foster Care Scotland Limited SWIIS International Limited	03985713 SC273400 04499819	Controlling company SWIIS International Limited. Ultimate controlling parties G S Dadral and K Dadral	No
Sunbeam	Sunbeam Fostering Group Limited	07298774	M Haneef, N Ahmed, K S Dhull. No Ultimate Controlling Party	No
Care 4 Children	Care 4 Children Holdco Limited	10082417	R Khan has significant influence or control. Directors do not consider there to be an ultimate controlling party.	No
Homes 2 Inspire	Homes 2 Inspire Limited	10592680	Homes 2 Inspire owned and controlled by Shaw Trust Limited	No

	Shaw Trust Limited	01744121 Charity 28775 Charity Scotland SC039856	Members/Trustees	
Sandcastle	SC TOPCO Limited	11532813	Ultimate parent undertaking is Waterland Private Equity Investments BV (Netherlands) No ultimate controlling party	Yes

Reporting periods



The list above shows all twenty provider groups studied, including identification of the legal entity at the top of the ownership chain. In addition, a brand name for each group is allocated as these may be more recognisable to readers. Appendix 3 lists recent acquisitions into these groups.

Each blue block in the figure above represents financial information retrieved for this study. For the UK based companies, the Companies Act 2006 generally requires companies and groups to submit independently audited accounts on an annual basis, and to do so within 9 months of the end of the year the accounts relate to (public limited companies (PLC) such as those listed on the London Stock Exchange (LSE) have only 6 months to do so).

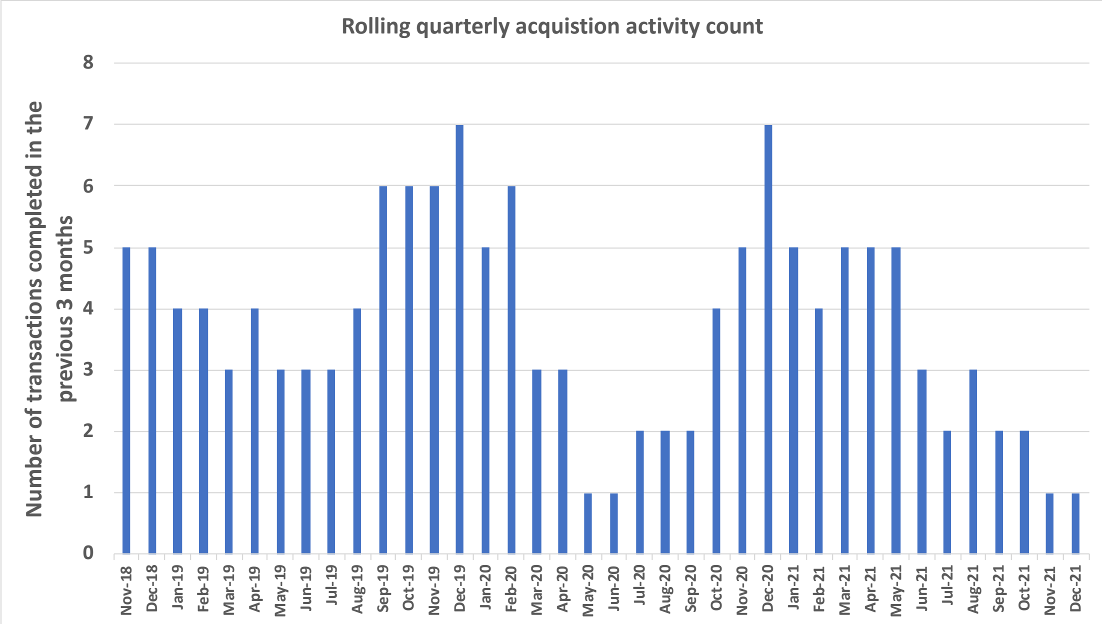
Companies can select the annual start and end date for financial reporting; hence companies report to a variety of different schedules. As can be seen in the figure above, companies use a variety of start/end periods for their reporting, and in certain circumstances can alter the length of the period reported to a longer or shorter period than the usual annual reporting.

The dark blue blocks are the most up to date information that has been published since the 2021 report and used in this update report.

Appendix 3

Acquisition activity trend.

The chart below is a rolling three-month count of the acquisition transactions reported by the top 20 providers in their statutory reporting.



Acquisition activity was increasing in the autumn of 2019 and early 2020 until the impact of Covid uncertainties and lockdowns on social care dampened the number of deals being concluded.

As discussed elsewhere in this report, as providers and their investors started to experience that the impact of Covid on their operations was limited the number of acquisitions began to recover in late 2020, albeit not yet attaining pre-Covid levels.

Note that 2021 levels shown may increase once information provided retrospectively by the filing of accounts for 2021/22 is available.

The full list of acquisition activity that underpins the chart above is listed below. The primary source of information about acquisitions are the disclosures made in the specific financial statements that form the basis of the whole report, although these are supplemented by additional information discovered in the public domain during this update. It is not intended to be a comprehensive list of all activity in the sector.

Date	Target	Acquiring Group
Sep 2018	Safehaven	Five Rivers
Oct 2018	Reach Out Care	SSCP/Stirling Square
Oct 2018	Core Assets Group	Nutrius/CapVest Equity
Nov 2018	Safehouses North	Five Rivers
Nov 2018	The Fostering Company North East	Five Rivers
Dec 2018	Sandcastle Care	Waterland Private Equity

Jan 2019	PiCS and Boston Holdco B	Nutrius/CapVest Equity
Feb 2019	House of Falkland (Westfield Jacob)	SSCP/Stirling Square
Feb 2019	Esland Group	August Equity
Apr 2019	Family Placement.com	SSCP/Stirling Square
Apr 2019	SFS	TACT
May 2019	Aurora Care Young People's Services	Horizon/NBGI
Jul 2019 (Dec 2019 – CMA clearance)	Outcomes First Group	SSCP/Stirling Square
July 2019	Queensmead Property	Witherslack/Charme Cap
Aug 2019	Horizon	Graphite Capital
Aug 2019	Help Me Grow Fostering Services	BSN/Alderbury
Sep 2019	Ferndale Child Care Services	Compass/Graphite
Sep 2019	Cressy Oasis Ed	Horizon/Graphite
Oct 2019	Portixol (UK)	Sandcastle/Waterland
Oct 2019	Sussex Fostering	BSN/Alderbury
Nov 2019	Pathfinders (bus acq)	Sandcastle/Waterland
Nov 2019	Portixol UK	Sandcastle/Waterland
Dec 2019	Tumblewood Project	Witherslack/Charme Cap
Dec 2019	Build-A-Future	Keys/G Square
Dec 2019	Cornerways Fostering Services	BSN/Alderbury
Feb 2020	Holistic Childcare (Gilmourbanks & High Trees)	OFG/SSCP/Stirling Square
Feb 2020	AS Investments (UAE)	Caretech
Feb 2020	Artemis/Unique Care Homes	Keys/G Square
May 2020	SWCS	Keys/G Square
July 2020	Oracle Care & Ed	Esland/August Equity
Aug 2020	Next Step Fostering (AW Consultancy & Lesley Ann Consultancy)	OFG/SSCP/Stirling Square
Oct 2020	Bryn Melyn	OFG/SSCP/Stirling Square
Oct 2020	Elevate Propco	Care 4 Children
Oct 2020	Smartbox	Caretech
Nov 2020	Enhanced Children's Services/Enhanced Foster Care/Wessex College	OFG/SSCP/Stirling Square
Nov 2020	Huntercombe Group (adult facilities)	Caretech
Dec 2020	North Lakes	Polaris/Nutrius/CapVest
Dec 2020	Capstone	Capstone Employee Ownership Trust
Jan 2021	Priory Ed & Care	Waterland Private Equity

Feb 2021	Elevate II Limited	Care 4 Children
YE Mar 2021	Mayne Enterprises	Compass/Graphite
Mar 2021	Dove Adolescent	Polaris/Nutrius/CapVest
Mar 2021	BSN Social Care	Significant control acquired by MML Capital Europe
Apr 2021	Area Camden Limited	Polaris/Nutrius/CapVest
May 2021	Southern Adolescent Care Services Limited	Keys Group
June 2021	Quality Foster Care	Five Rivers/Midhurst
Aug 2021	Priory Ed & Care	Aspris Holdco
Aug 2021	Witherslack	Mubadala Capital invests
Nov 2021	REHAVISTA GmBH	Caretech

Appendix 4

Limitations of data and areas for potential further study

Limitation	Further study
Statutory accounting information includes some useful details in relation to debt repayment schedules, but the accounts are historical and do not offer information to assess ability to pay.	Further scrutiny of the terms of loans and other financing and the internal stress testing performed for going concern consideration would require additional disclosure by providers.
There is a perception of a lack of clarity as to responsibility for monitoring of provider solvency and performance.	The CMA have raised this concern and are consulting the sector about the potential for a monitoring regime.
Information at Companies House is historical and for corporate bodies only (i.e., excludes partnerships)	Extra-statutory reporting of management information and forecasts by providers.
Information at Companies House is limited for small and medium sized providers.	Consider additional disclosure requirements for all providers of children's social care services through statute or via a sector-led transparency code.
Information is usually for the whole company or group and not reported segmentally.	Consider development of a sector-led transparency code.
Profitability of some provider organisations is not completely visible due to transactions with other related parties or use of partnership structures.	Carry out EBITDAR (and other measures) analysis and interview providers. Consider development of a sector-led transparency code.
Charity accounts are not always suitable for this type of analysis and other issues arise for charities (e.g., pension liabilities)	Consider development of a charities-sector specific study.
Monitoring of return on investment made by private ownership is not a statutory requirement and sometimes not possible through reconstruction.	Consider development of a sector-led transparency code or increased disclosure regulation.