Spring 2013

Health & Care Focus

A helping hand for lifelong prosperity

Contents:

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

What's the weather?

Our assessment of the market

Over the last year, the independent social care market has continued to suffer from low, zero, or even negative fee growth combined with inflationary cost pressures.

Operators are increasingly focussing on alternate ways of growing the top line, as well as managing their cost base and as a result profits are generally remaining steady. Although quite often it can appear that operators are 'running just to stand still'.

As a consequence, the market for good quality operators remains strong, both in terms of ability to raise bank debt or to sell. Poor or declining quality operations are increasingly less attractive for either bank debt or sale as a going concern.

Private Equity finance is still abundant with many investors looking at businesses currently up for sale. It is fascinating to see how many bidders there are for businesses of a reasonable size. This source of finance is playing a key part in driving the demand for successful business acquisitions and has a direct impact on multiples across the whole sector.

Listed companies are also seeking a slice of the healthcare cake. Mitie, a FTSE 250 company, acquired Enara, the fourth largest domiciliary care provider in the country, for £111m in October 2012 and Interserve acquired Advantage Healthcare in December 2012.

Whilst domiciliary care has accounted for 40% of healthcare transactions in more recent years, it is clear that there are some other areas also showing movement. An overview of each sector is below:

In the year ended 31 December 2012, Hazlewoods continued to be a significant adviser on health and social care transactions, advising on 32 healthcare transactions with a combined value of £373m.

To discuss how we can help you in relation to acquisitions or disposals, please call Andrew Brookes or John Lucas on 01242 246670.

Sector	Outlook	Recent Value Trend	Activity
	☀ ☁ 🌧	↑ ↔ ↓	
Elderly (Nursing)	☁	↔	Continued low levels of bank funding has meant values have remained low and fewer transactions are taking place. New builds receive greater interest, with increasing private equity interest in this area.
Elderly (Residential)	🌧	↓	Increased demand for domiciliary care has resulted in less interest in this sector, which, combined with reduced bank funding, has led to fewer transactions. However, larger dementia homes or niche homes remain attractive.
Domiciliary Care (Elderly)	☀	↔	Demand for these services has increased, leading to further consolidation of the market. Increased interest from private equity is allowing values to remain high. Larger companies receive significantly higher multiples than their smaller counterparts.
Domiciliary Care (Specialist)	☀	↑	Specialist care is attracting substantial interest from private equity investors and a number of existing trade acquirers, with increased demand for larger-sized transactions.
LD (Residential)	☀	↑	Renewed interest from private equity investors with the realisation that supported living is not suitable for all clients with learning disabilities, however multiples remain significantly below peak levels.
LD (Supported Living)	☀	↑	Transactions continue to take place in this area, with acquirers often looking to buy trade only and not freehold property.
Mental Health (Residential/Supported Living)	☁ ☀	↔ ↑	Similar profiles as above for LD, also with some renewed interest in residential, mental health and secure units.
Acquired Brain Injury	☀	↑	Quality businesses still experience high levels of demand, supported by non-Government funding. Values continue to be high. Trade and private equity actively pursuing any opportunities.
Children's Services (Residential)	☀	↔	Renewed interest from private equity investors has meant the previously limited number of investors has improved. Occupancy levels and demand remain high, with multiples consistent for quality assets.
Children's Services (Fostering)	☀	↔	Premiums remain for larger businesses, with smaller operators attracting lower multiples. As with domiciliary care, the market continues to consolidate.
Day Nurseries	☁	↔	Poor performing area for transactions, as values are still greatly determined by underlying freehold property values. Financial institutions offer low levels of funding.

Payroll Real Time Information - are you ready?

The next 6 months will see fundamental changes to the way employers report Pay As You Earn information to H M Revenue & Customs (HMRC). Employers will be required to submit complete and reconciled data to HMRC after every pay run rather than the present system of reporting once a year.

Real Time Information (RTI) will for the first time provide HMRC with a detailed overview of your payroll information during the tax year. All employers will be required to operate their payroll using RTI from October 2013 with some, dependent upon the size of their payroll, going live between April and September 2013.

We can help

In order to meet the new requirements you will need to have a payroll system that is ready for RTI. With such large numbers of staff being paid based on ever-changing rota patterns, healthcare businesses may find the transition to RTI challenging.

Hazlewoods operate the latest payroll software and are a registered BACS bureau. We have also been involved in the HMRC pilot scheme since November 2012 for many of the businesses where we look after their payroll.

We recognise that change provides challenges and would be happy to discuss your payroll requirements. Our qualified and experienced team are here to remove the anxiety that payroll can bring.

Some fun (if it is not you!!) facts from HMRC. Currently, HMRC has on its records:

- 824 employees with the surname 'Unknown'
- 507 employees called A.N Other
- 160 surnames of 'Test' and 100 with 'do not use'

- 128 staff entered Mr, Ms or Mrs 'Dummy'
- Over 3000 employees with an NI number of AB123456 or AA111111
- 40 employees over the age of 200 years!

Please contact any member of the healthcare team for more information.

Tax Savings - easy as ABC

The use of "alphabet shares" by small and medium enterprises (SMEs) are well established and can be very useful from a commercial perspective and also provide significant tax savings.

What are Alphabet Shares?

Alphabet shares are ordinary shares of different classes, often described as 'A' shares, 'B' shares, 'C' shares etc. and hence the name! By sub categorising shares in this way the owners of a company are able to allocate different rates of dividend to each class of share which can be extremely useful in minimising exposures to taxation, particularly in family companies. This article highlights some of the ways Alphabet Shares can be deployed.

Dividend planning

By having different classes of share a Company is able to declare dividends on individual classes of shares rather than all of the ordinary shares. This can be very useful particularly in family companies. Issuing alphabet shares to family members can help maximise the use of available tax allowances for the family as a whole and minimise tax.

For example the owner of a family company wishing to pay a dividend of £65,000 per annum could save higher rate tax in excess of £9,000 per annum by issuing shares in a separate class of shares to a spouse with no other sources of income and allocating the dividend between them in the most tax advantageous way.

Business Partners

Many small companies operate in a similar way as a partnership, with each person working in and owning a share in the business. Different classes of Alphabet Shares are useful where co-owners require flexibility in the way in which they share the profits, but maintain fixed capital and voting rights.

Potential pitfalls

Salary sacrifice

If an existing employee is given shares in return for reducing their salary so they are paid dividends instead, HMRC could argue that the dividend is disguised remuneration and tax it as such. This also applies if an employee receives dividends instead of a contractual bonus, or as part of a bonus arrangement.

Inheritance tax

Ordinary shares in a family company can be gifted to other family members, such as spouses and children who are not minors, without any capital gain arising. A potential pitfall exists though in that if the recipient died within two years of receipt of the shares a capital gain could arise that would not be covered by Business Property Relief.

Limited rights

It is usually important that all classes of Alphabet Shares have identical voting and capital rights.

Take advice

HMRC can and do challenge the use of Alphabet Shares in some situations, however there are many situations where Alphabet Shares can be used. We recommend that you contact us to ensure that you can legitimately benefit.

If you want to find out more about Alphabet Shares please contact us.

Financial due diligence - finding the skeletons in the cupboard

Hazlewoods has an enviable reputation in carrying out insightful and in-depth financial due diligence for acquirers of healthcare businesses.

The Hazlewoods approach helps acquirers identify the true financial story behind the target business.

Is the reported profit maintainable?

Our due diligence methods developed from many years of experience in the sector help acquirers assess whether reported financial performance is maintainable or, indeed, whether improvements could be possible.

Our work typically includes, among many other lines of enquiry:

- Looking at trends in both hours/care packages/occupancy and fee rates, to assess the ongoing impact on the profitability of the business. This includes assessing likely future changes. An analysis of this data helps establish if the past profits are sustainable or not.
- Consideration of staff rosters and rotas to check that the business is actually providing the level of care it is contracted to provide and indeed billing. We have found that this analysis has been telling on a number of occasions.
- A detailed analysis of overhead costs, to assess whether historical costs reflect the likely maintainable level of future costs e.g. reduced levels of discretionary spend in recent periods or pending rent reviews which could reduce profitability.
- An assessment of the seller's role in the target business. Many care businesses are owner managed, with the owners taking profits from the business by way of dividends, rather than a commercial salary. It is important to identify the cost of replacing the vendor's role or family members in the business after it has been acquired.

How much cash is needed to run the business after acquisition?

Another key part of due diligence enquiries is to assess the level of working capital that is required to run the target business. Most businesses are acquired on the basis that the acquirer will not have to inject more cash into the business after acquisition to fund the working capital cycle. We carry out detailed analysis of working capital trends to identify how much money the business typically has tied up in its receivables less its payables at any point in time. On numerous occasions this analysis has helped acquirers negotiate more favourable transaction terms than might otherwise have been the case and ensured they do not have to put more money in to run it!!

Our due diligence processes often enable clients to negotiate a reduced price for the target business.

If you would like to know more about our due diligence services, please contact us.

Are you paying more VAT than you need to?

Most services provided by operators in the care sector are exempt from VAT, and generally there are few opportunities to register for VAT and to recover VAT on business expenditure.

This does not mean, however, that the 20% VAT cost you suffer on invoices should be accepted as an inevitable consequence of making purchases from VAT-registered suppliers.

Some operators (particularly residential) will qualify either for the zero or reduced-rate of VAT. In addition, there are other general zero-rate reliefs which suppliers will often fail to consider when calculating the VAT charge.

In addition, whilst there are no blanket VAT reliefs for charities, charitable care home operators can benefit from certain zero-ratings for specific supplies.

Where a supplier has charged an incorrect excessive rate of VAT, they should be asked to make the appropriate refund. Provided the original supply took place within the previous 4 years, the supplier can adjust their VAT records to recover the VAT from HM Revenue & Customs, so ultimately the refund can be made at no cost to the supplier.

We have carried out a significant number of VAT reviews for care operators, and have consistently identified substantial VAT refund opportunities.

We really do think we may be able to save you some VAT!

If you are interested in identifying potential VAT-saving opportunities for your business, please contact us.

How much is your business worth?

If you are reflecting on your retirement options, thinking of restructuring your business or are just generally interested in how much your business is worth, knowing how to value a business is a very useful tool.

There are a number of recognised business valuation methods, but the principle technique used in the healthcare sector uses a multiple of a business's maintainable Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA).

In reality the EBITDA figure used in the calculation will be based on the currently achievable profits of the business ("run rate"), which might be quite different to the results reported in the last annual accounts.

If a company is being sold the 'headline' valuation is then normally, i) increased by the amount of any cash or surplus assets and ii) reduced by the amount of any borrowings/debt and by any tax liabilities accruing on profits up to the date on which the company is sold.

A price based on a multiple of EBITDA assumes that all of the assets necessary to run the business are included in the price. This includes items such as property, equipment, vehicles and a normal level of working capital.

During the financial due diligence process the accountants for the acquirer assess what they consider a normal level of working capital to be. If the actual value of working capital at completion day is different to the agreed normal level an adjustment is made to the purchase price.

See opposite for an illustrative example.

Our expertise and knowledge of the market place can help you arrive at the value you deserve when selling your business.

If you would like to discuss the value of your business please contact John Lucas.

	£
Net profit for the year before tax	250,000
Add:	
Interest paid and received	10,000
Depreciation and amortisation	10,000
Non recurring expenses	80,000
Adjusted EBITDA	350,000
Multiple	4x
Value before adjustments for cash, debt and working capital	1,400,000
Less:	
Debt	(450,000)
Tax liabilities	(100,000)
Add:	
Cash	60,000
Working capital adjustment	20,000
Price Paid for shares in the company	£930,000

Company Corner

How do changes in the Corporation Tax Rules impact you?

Reduction in corporation tax rates

From 1 April 2012, the main rate of corporation tax reduced from 26% to 24%. It reduced again to 23% on 1 April 2013, to 21% on 1 April 2014 and 20% on 1 April 2015! The small company corporation tax rate however remains unchanged at 20%. Accepted wisdom in the past was that it was beneficial for a business to operate with as few subsidiaries as commercially possible as the threshold at which higher rates of corporation tax is paid is divided by the number of companies in the group. With the full rate moving closer to the small company rate the tax savings of having a smaller group are much diminished, athough there are still important benefits in terms of the timing of payment of Corporation Tax.

The tax cost differential is now such that thought is needed as to whether more companies is beneficial in case you want to dispose of a part of your business!

Changes in capital allowances

From 1 April 2012 the main rate of capital allowances fell from 20% to 18% and the special pool rate which applies to integral features in a building reduced from 10% to 8%.

With effect from 1 January 2013, the Annual Investment Allowance ('AIA') increased from £25,000 to £250,000 per annum. In essence, this means that the first £250,000 of qualifying capital expenditure incurred attracts tax relief at 100%. Directors of a company should consider planning the timing of their capital expenditure to optimise the use of this annual allowance. There might also be opportunities to claim capital allowances in relation to the development expenditure on properties and our specialist advice can often enable companies to claim relief on expenditure they had not previously known was eligible.

Potential payments on account for corporation tax

Where a company has taxable profits giving rise to corporation tax being paid at the higher rate (24% to 31 March 2013 and now 23%) and the profits exceed this threshold for two consecutive years, that company is required to make payments on account (four per annum) of its corporation tax. These payments fall due 14 days after the end of the last two quarters of the accounting year in which the profit is earned and 14 days after the first two quarters after the end of the accounting year. Clearly this has a serious impact on cash flow as small companies do not have to pay tax on profits until 9 months after the end of the accounting year .It is therefore important to regularly review projected taxable profits and plan ahead for this scenario.

For more information please contact us.

Keeping you in the loop

For all the latest news and views on the industry, follow our Health and Care Team on Twitter.

All you need to do is search for @HazlewoodsCare

Andrew Brookes
Partner and
Head of Healthcare
t: 01242 237661

David Main
Partner
t: 01242 246670

Rachael Anstee
Healthcare Director
t: 01242 237661

John Lucas
Partner
t: 01242 246670

Our Health and Social Care Team is happy to discuss matters arising from this newsletter, as well as any other issues relating to your business or personal financial affairs.

The services we provide include:

- Accountancy and bookkeeping
- Taxation planning
- Management accounts
- Strategic planning
- Audit
- Raising finance
- Acquisition searches and advice
- Financial and taxation due diligence
- Confidential business disposals
- Sage advice and training
- Financial planning
- Payroll assistance to include bureau service
- Benchmarking and profitability advice
- Incorporation

HAZLEWOODS
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Windsor House Bayshill Road Cheltenham Gloucestershire GL50 3AT
Tel: 01242 237661 Fax: 01242 584263

www.hazlewoods.co.uk