CARE ENGLAND
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Annex G: Exit preparedness and selling services

May 2024

The sale process

The process of buying and selling a business mirrors the intricacies of real estate transactions, with several distinct phases that demand careful consideration. From marketing to completion, each stage plays a crucial role in determining the success of the transaction. Potential purchasers are introduced to the business through high-level summary information, a critical step in generating interest. This initial pitch serves as the foundation for the subsequent stages of the process. Offers are sought from interested parties based on the provided summary information. This phase acts as a litmus test for serious buyer engagement, setting the tone for the negotiations that follow.

A select group of potential purchasers, chosen based on the perceived value of their indicative offers, dives into detailed information about the business. This thorough exploration includes site visits, engagement with professional advisers, and meetings with management. It's a comprehensive yet often intrusive part of the process. This due diligence phase, which can run concurrently with other stages, allows potential buyers to gain a deeper understanding of the business. Engaging legal and financial experts becomes crucial during this time to address any questions and concerns.

The legal aspect of the transaction comes to the forefront as legal documentation, including the Share/Asset Purchase Agreement (SPA/APA), is drafted, negotiated, and agreed upon. This stage demands specialist legal advice, and often tax and accounting advice, to navigate the complexities and nuances of the negotiations.

The culmination of the process involves the signing of documents, satisfaction of Conditions Precedent (CPs), and the flow of funds between the buyer and seller. This step may occur concurrently with signing or may involve a gap between signing and completion.

The number and nature of potential purchasers, as well as the specificities of each transaction, dictate the variations in the process. While a typical timeline is cited as 3-6 months, the structure of the deal (whether it is a Share Sale or Asset Sale) and organisational preparedness can significantly influence the duration. Implementing an 'exit readiness strategy' ahead of a formal sales process, particularly if succession planning is required, can extend this timeline to more than a year.

On top of all of this, there are critical elements for maximising proceeds. A clear vision and strategy for the future, driven by a stable and continuing leadership team, are essential.

Exiting parties should be demonstrably 'hands-off' and non-critical to the future success of the business. Furthermore, detailed information should not only confirm the initial summary but also support purchasers and investors in understanding and becoming comfortable with the business they are acquiring. Also, encouraging multiple buyers to compete against each other ensures a robust negotiation environment where each party strives to present their most favourable terms.

In essence, the sale of a business is a multifaceted process, demanding strategic planning, transparency, and adept negotiation skills at each stage. Successful navigation through these phases can lead to a transaction that not only meets the financial objectives of the parties involved but also sets the stage for the future success of the business under new ownership.

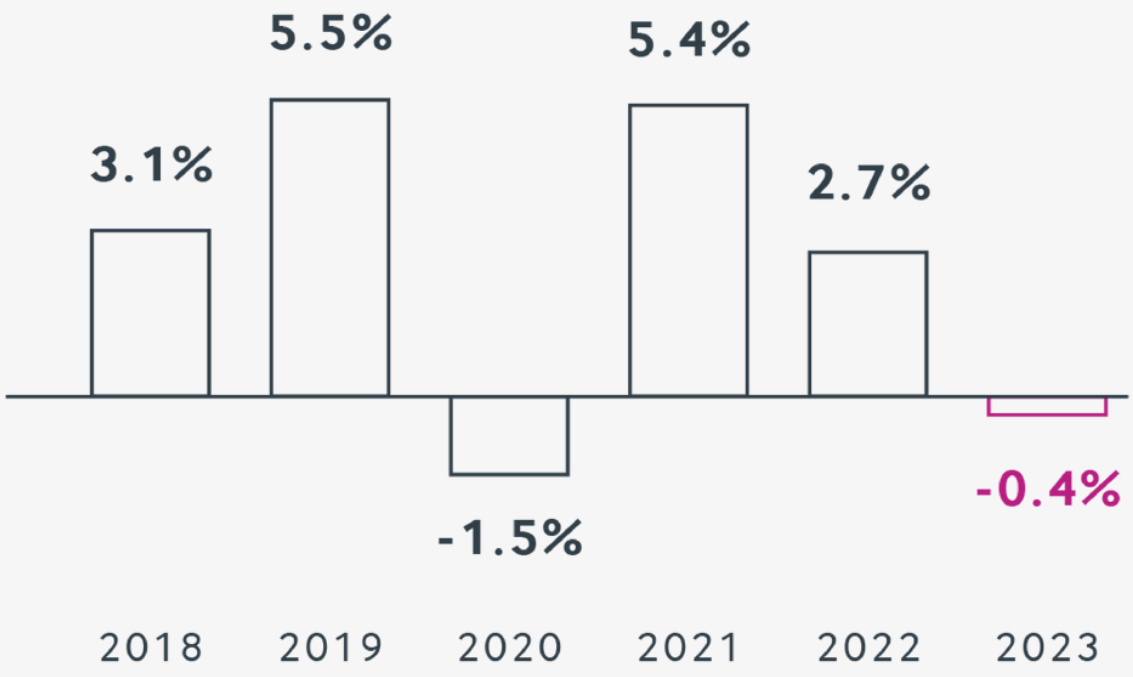
Value vs price

In the intricate world of business transactions, the interplay between value and price is a central theme. Contrary to the notion of an intrinsic or fundamental value – an objective and universally agreed-upon benchmark – value is an inherently subjective concept. It hinges on the diverse perspectives and requirements of different actors, entwined with a multitude of assumptions, particularly those associated with risk and potential. Furthermore, value is not static; it evolves with changing conditions, assumptions, and the emergence of new information.

Various models and methodologies, such as multiples of EBITDA, are employed to estimate value. However, ultimately, value converges into the tangible realm of price – the amount someone is willing and able to pay. This is contingent upon their unique investment or lending criteria, risk tolerance, and understanding of the business and its future potential. Maximizing and realizing value, therefore, becomes a nuanced art of comprehending investors' and lenders' criteria and facilitating their understanding of the business. This involves presenting information in a meaningful format, allowing them to de-risk their assessment and attribute value to the business post-change of ownership.

In 2023 there was a strong appetite for care businesses reported and, despite the increases in operational and borrowing costs, the market remained broadly flat in terms of values achieved, with just a 0.4% drop in pricing for the year (source: Business Outlook 2024). Overall, there were very few deals completed at the top end of the market due to the cost of debt and softening yields. In contrast, the mid-market saw profit levels hold up despite increasing costs - this can be largely attributed to the continued recovery of occupancy.

PRICE INDEX



Source: Christie & Co

Preparing businesses for sale

Selling your care business can be an emotional process; it is understandable that after investing time, effort and resources into building and running the business, there may be sentimental attachments and personal connections involved. It is a decision that will be affected by several factors, including timing, market challenges and the "saleability" of your business.

While emotions can play a role in the decision-making process, early-stage preparation is crucial and can help to ensure maximum return on the investment made into the business. Having a specialist team on board from the outset will ensure the provider is in the best position to navigate the sale process. Several points can be dealt with ahead of a sale to mitigate the risk of complications and/or delays during the sale process.

Overcoming some of the challenges of selling

Successfully navigating the intricate landscape of business exits requires a nuanced understanding of common challenges and proactive strategies for their resolution. Sellers frequently encounter hurdles when insufficiently prepared for the sale or unable to furnish comprehensive information to potential buyers and funders. This lack of transparency often hinders a thorough understanding of the business and its associated risks, impacting the overall success and value maximisation of the transaction. This can also delay the transaction and incur additional costs for the parties, preparation is key.

There is a significant contrast between 'lifestyle' and 'corporate' business models. Individual or family-owned businesses are often characterised by a hands-on approach, utilising the business to fund their lifestyles. This results in streamlined operations, lacking the formal infrastructure and delegation of authority that professional investors or lenders typically expect. Neither model is right or wrong, it's more that different actors have different objectives and/or requirements and therefore operate their businesses differently. The misalignment in business models can lead to conservative assumptions by investors, impacting their perception of EBITDA and introducing a significant disparity in valuation between buyers and sellers, and the transaction potentially failing.

A suggested solution is a strategic shift from a lifestyle to a corporate business model ahead of the exit. This involves aligning the business operations with the expectations of potential buyers and addressing the structural disparities that may exist. Legal and financial advisers can help navigate through the process in readiness for sale.

Owner-managed SMEs often fall short of providing the levels of detailed information that professional investors require. Monthly management accounts, board minutes, strategy documents, forecasting, and budgeting – these essentials may be absent or incomplete. The lack of historical emphasis on maintaining such detailed records can lead to misunderstandings and hinder the accurate assessment of the business's value.

To remedy this, a "clean-up" of business practices and the establishment of a more formal reporting regimen. This becomes an integral part of an exit readiness strategy, ensuring that the business can meet the heightened information expectations of potential buyers and funders. This process can be overwhelming and time-consuming for many sellers as it takes you away from the day-to-day running of the business, but it is an essential part of the process to maximise the value of the business and ensure the business is ready for sale.

A crucial challenge is the absence of robust succession planning. Even when owner-managers ostensibly step back from day-to-day operations, they might look to remain heavily involved in decision-making. The lack of a tested leadership team to drive the business forward limits exit options to trade buyers or investors who will bring in their team, which is a riskier proposition and therefore carries a valuation discount or challenges in completing a transaction, e.g. more onerous warranties and indemnities.

The recommended solution involves recruiting, embedding, and delegating authority to a leadership team as part of an exit readiness strategy. This ensures a smooth transition post-exit, making the business more attractive to potential buyers or investors.

Professional investors and lenders often subject businesses to standard and rigorous due diligence requirements. These demands can be overwhelming, appear irrelevant (if it appears to contradict the methods of a business that has been successfully operated for many years), and are time-consuming for sellers. As a remedy, consider vendor due diligence as part of an exit readiness strategy. While incurring upfront costs, this proactive approach allows potential issues to be identified and addressed early in the process, streamlining the due diligence phase during the formal sale.

Addressing these challenges in further detail involves a tailored approach, acknowledging the specific context of each business. By strategically implementing these remedies, sellers can significantly enhance their chances of a successful business exit and maximise the value derived from the transaction.

Build a transaction team and go to market with a favourable structure

Taking advice from corporate finance advisers and corporate lawyers, ideally, those who have relevant experience in the care sector, is key. These advisers can work with the provider at an early stage to help your business achieve "maximum value" and advise them on the structure of the sale so that the business goes to market with a favourable tax structure. Providers will need to consider aspects like whether the sale should be a share sale or an asset sale and the tax (and other) implications of either option.

Pre-sale "housekeeping"

During the sale process, the buyer's lawyers and financial / tax advisers will conduct due diligence on the business. This is essentially a process whereby the buyer's advisers will raise a series of financial, legal and tax enquires to allow them to "kick the tyres" of the business. They will then report to the buyer on their findings.

Experience has shown that accurate and quality information provided at the due diligence stage installs confidence in buyers, this, in turn, minimises the chances of an avalanche of additional enquiries and reduces the opportunity for re-negotiation on price.

To enable the sales process to run as smoothly as possible, any areas which could raise potential red flags should be dealt with as far in advance as possible.

The key areas of due diligence that the buyer's team take a particular interest in are set out below.

a. Employment/ HR

The buyer's advisers will pay close attention to employment documents, namely the businesses' employment contracts. The increasing use of overseas staff in the sector has resulted in a focus on immigration compliance. They will also raise enquiries regarding the immigration status of the business's employees and whether any sponsorship licences are held and/or needed. The due diligence process will include enquiries on the right-to-work process and the business's monitoring/checks. If they are not satisfied with the business's processes, the buyer will likely seek protection via specific indemnities for any employment issues that are identified. As such, it's good to get ahead of any issues and deal with them pre-sale if possible.

Failure to pay holiday pay correctly for overtime continues to be a problem and buyers are also focusing on whether furlough rules were complied with as HMRC continue to investigate error and fraud from the pandemic.

b. Property

If a care business relies on leasehold properties, the buyer's advisers will inevitably want to review each of these leases. If they are not happy with the terms of such leases (e.g. the provider has entered into an assured shorthold tenancy with a nominal notice period), the buyer may require these leases to be renegotiated before completion. Being on good terms with a landlord(s) can help.

If the business owns any freehold property, having any property documents and deeds to hand will be helpful in terms of timing. It can also be beneficial to engage the lawyers to prepare the commercial property standard enquires known as CPSEs and review the title of the property before the business goes to market. This early preparation will help root out any pre-sale issues which could be rectified before the buyer gets involved, thus ensuring the transaction runs smoothly and efficiently.

Any historic works at the property will need to be disclosed so making sure planning documents, building regulations and any construction contracts and warranties are in order is another important requirement.

c. Health and Safety

Fire remains, a "hot topic" and it is often the case that only an internal fire risk assessment has been undertaken which does not provide any guarantees that the property is fire-compliant. As a seller is likely to have to warrant compliance, an external fire risk assessment is advisable.

d. Environmental

Environmental issues are of particular importance therefore ensuring the Energy Performance Certificate is up to date is vital as that can cause delays.

e. Ownership of assets

The buyer will want reassurance that they are buying everything they deem necessary to run the business post-completion. If there are any assets, including the ownership of the business's domain names or any supplier contracts, which are not in the business's name (e.g. they are instead in the seller's name), they will most likely need to be moved into the business's name before completion. Again, identifying any potential issues and dealing with them before taking the business to market can help reduce any complexities and assist from a timing perspective.

f. Protection of intellectual property ("IP")

The buyer's advisers will raise enquiries regarding the ownership of any IP used by the business, for example, websites, so it will need to be clear as to who owns this IP.

g. **Site visits**

Services will need to think carefully about how to manage requests for site visits from a buyer and its team. Whilst it is reasonable to limit access due to concerns about confidentiality or public health, red flags will arise if access is refused outright as this may indicate that you have something to hide.

Timing

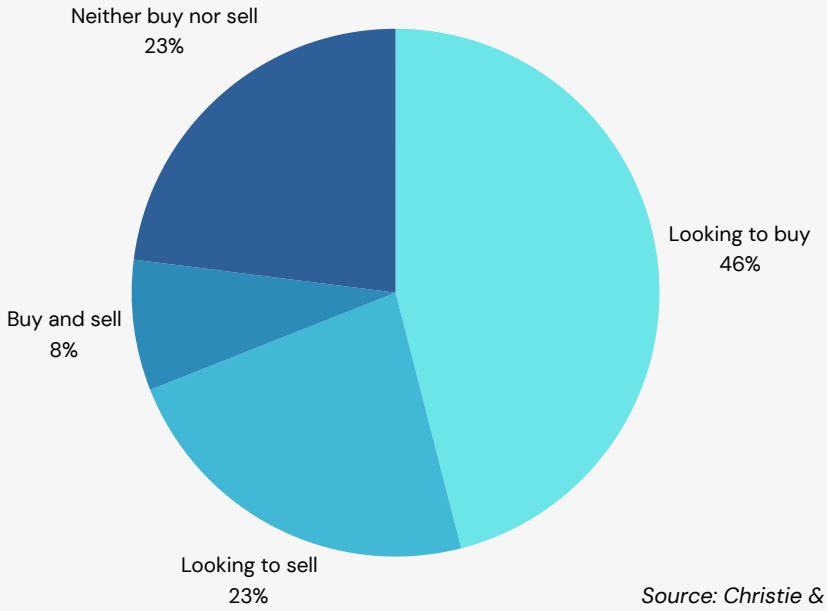
Once the seller accepts an offer from a buyer, it is sensible to agree to a short "heads of terms" document. The heads of terms will set out expectations for timings and can clarify key points such as exclusivity, purchase price mechanisms and structure, the buyer's expectations for the seller's post-completion role (if any) and any conditions to the transaction. Heads of terms are essentially a non-binding framework for the transaction.

Lawyers and financial advisers will be instrumental in drafting and negotiating the heads of terms so the seller must have built the transaction team before signing any heads of terms.

Understanding the current market

Despite the undoubted economic headwinds, the care sector remained resilient in 2023 and is expected to remain positive for 2024, with one report indicating that 77% of people surveyed are looking to buy and/or sell a care business in 2024.

Sentiment Survey: Acquisition Plans in 2024



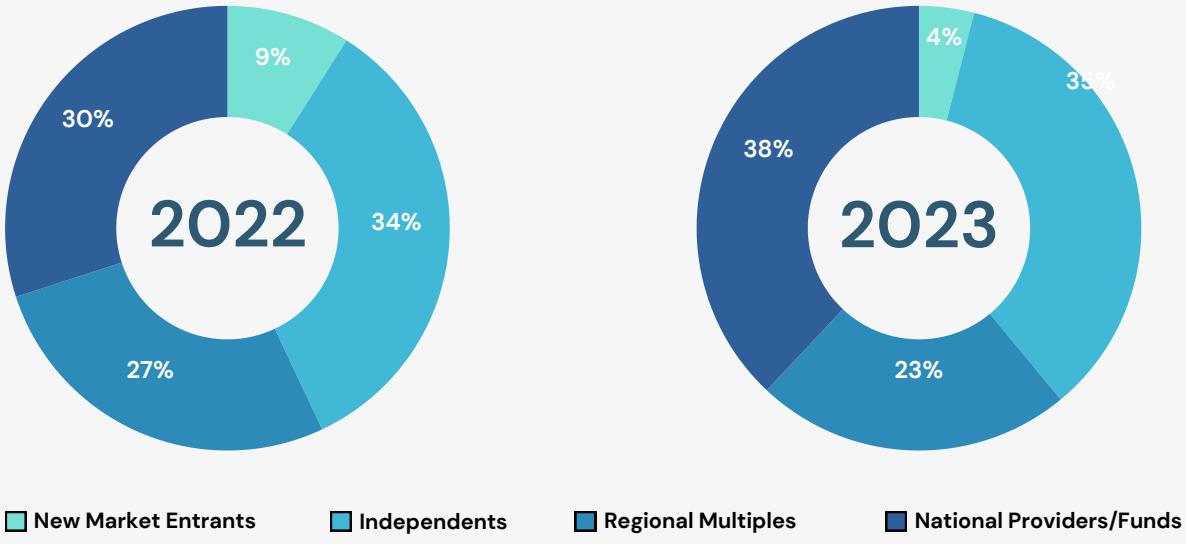
Source: Christie & Co

In its current form, the market landscape reflects a certain level of distortion due to the fragile nature of the sector and the influence of larger providers selling multiple homes. Many acquirers are focused on opportunities with bigger consultancies or those with a louder voice, making it challenging for smaller providers to be seen and heard who may equally wish to exit the market or dispose of assets.

However, as larger transactions decrease over time, new possibilities for mergers and acquisitions are anticipated, bringing a more optimistic outlook for the market.

To give a view on the composition of the market, in 2023, 35% of buyers acquiring care homes through one of the consultancies that contributed to this report were independently run, 38% were national providers or funds, 23% were regional multiples, and just 4% were first-time buyers. This is similar to numbers recorded in 2022, which demonstrates stability in the UK marketplace.

Analysis of buyer types



Source: Christie & Co

Despite the challenges, the independent adult social care sector continues to attract investor interest, which smaller providers can still benefit from. The sector's robust fundamentals, driven by demographic shifts demonstrating an ageing population with higher care needs and more working-age adults needing long-term support, contribute to its long-term stability. The sector is also paving the way for health and social care-related innovation and is a key part of health in England. However, this landscape is evolving, care providers must adapt and innovate to meet the changing needs of those they care for.

Despite challenges, such as the shortage of quality beds and services, there are positive indicators, including increasing average fees and occupancy rates returning to pre-pandemic levels. This supports the overall value of care businesses, making the sector more appealing for investment. However, smaller providers may experience a delayed impact compared to larger care provider groups. Investors currently prefer focusing on good-quality standing assets rather than second-generation or brand-new homes. Ensuring profitability and viability is crucial, with investors assessing a provider's ability to deliver high-quality care and maintain rent payments over extended lease periods. The trend towards nursing care has shifted in some areas, with an increased emphasis on the elderly residential sector, especially attracting international investment.

Specialised care, such as dementia units, is also gaining attention, offering higher fee rates to accommodate the projected rise in complex resident needs.

The appeal of businesses in the care sector lies in their ability to attract investment, with a growing emphasis on sustainability. Investors and lenders now consider environmental, social, and governance (ESG) factors. Smaller providers need to not only discuss sustainability initiatives but also present practical plans for effective implementation. Proactive measures in recruitment and retention, positive CQC ratings, and favourable customer reviews enhance interest and underline sustainability and service quality.

Investors and lenders seek businesses that are future-proofed and demonstrate a genuine commitment to service sustainability. Articulating strategies to manage increased cost bases, anticipating industry changes, and actively marketing homes and services, therefore, contribute to a favourable investment or lending profile. Proactive measures taken by providers to address recruitment and retention challenges, positive CQC ratings and favourable customer reviews also enhance interest, underlining both their sustainability and quality of services.

The reputation of the care sector poses a significant hurdle in attracting investment. Despite consistently offering value for money and empowering those in need, the external narrative often overlooks these positive aspects. Building a positive reputation and instilling confidence in investors is crucial for long-term sustainable growth, not just for individual care providers but for the entire sector.

Despite challenges, the social care market holds room for a positive outlook. It remains dynamic and resilient, presenting growth and development opportunities. Investment prospects in the care sector are enticing, contingent on addressing critical factors such as a positive reputation, industry challenges, stable fee rate increases, growing demand, and available capital. By considering these factors, the care sector can pave the way for a resilient and thriving future in M&A activity.

Strategic Asset Optimisation for an Exit Strategy

Introduction

In the care sector's complex and changeable environment, strategic exit planning and asset optimisation are pivotal for care home owners aiming to maximise exit value. A consultancy specialising in care home management showcased its expertise by significantly enhancing the EBITDAR (Earnings Before Interest, Taxes, Depreciation, Amortisation, and Rent) of a care home group in the North West. This strategic input not only bolstered the operational efficiency of the care homes but also markedly increased the value gained by shareholders at the owner's exit.

The Challenge

The proprietor of a small care home group in the North West was confronted with the challenge of preparing for an exit in a market increasingly prioritising operational excellence and governance, alongside the rising importance of Environmental, Social, and Governance (ESG) criteria. Despite possessing valuable assets, the outdated operational frameworks and less-than-optimal EBITDAR of the care homes risked diminishing the business's value in a competitive landscape. The owner was in search of a strategic ally to uplift the operational and financial performance of the care homes prior to sale, thus elevating the assets' appeal to prospective purchasers.

The Consultancy's Role

Faced with the task's urgency and complexity, the consultancy initiated a detailed asset optimisation endeavour. Their approach involved:

- **Operational Revitalisation**: The introduction of best practices and efficient operational systems aimed at enhancing care quality and operational efficacy, thereby positively influencing the care homes' EBITDAR.

- **Financial Restructuring**: A comprehensive financial review was undertaken to pinpoint and eliminate unnecessary expenses, refine staffing models, and bolster revenue through strategic pricing and service diversification.

- **Governance and Compliance Enhancement**: The consultancy strengthened governance structures to surpass regulatory requirements, particularly in meeting ESG standards, which are of growing interest to investors. This included the adoption of sustainable practices, ethical governance, and social responsibility promotion.

- **Market Positioning**: Through targeted marketing strategies and reputation enhancement, the care homes were repositioned in the market, attracting a wider pool of potential residents and increasing occupancy rates.

Outcomes

The consultancy's strategic focus on operational effectiveness and market repositioning led to the care home group's transformative outcomes, providing a blueprint for successful exit strategies:

- **Enhanced EBITDAR**: A significant uptick in the care homes' EBITDAR was observed, directly translating to a higher asset valuation and ensuring greater shareholder returns upon exit.

- **Regulatory Compliance and Reputation Boost**: The emphasis on governance and compliance elevated care standards, acknowledged by regulatory bodies, and improved the homes' reputation in the market.

- **Increased Occupancy and Fee Rates**: Thanks to operational enhancements and strategic marketing, occupancy and fee rates saw a notable increase, further strengthening the financial health and appeal of the care homes to potential investors.

- **Successful Exit**: The owner realised a lucrative exit, benefitting from the strategic optimisations and management enhancements undertaken by the consultancy.

Conclusion

This case underscores the significance of detailed preparation and operational refinement for achieving a successful exit. Through focusing on operational efficiency, financial restructuring, governance improvement, and strategic marketing, the consultancy not only uplifted the operational and financial standing of the care homes but also maximised shareholder value at exit. This narrative exemplifies the vital role of strategic consultancy in navigating the care sector's intricacies, enabling care home owners to secure a profitable and seamless exit process.