DOMICILIARY CARE FINANCES

REPORT BY:

OPUS RESTRUCTURING LLP

AND

COMPANY WATCH

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INTRODUCTION

The financial state of the UK's domiciliary care sector has been the subject of increasing debate and public concern since government austerity measures began to bite into local authority budgets and as the largest by far cost component for most domiciliary care providers, labour costs have risen inexorably to increasingly unsustainable levels. Company Watch and Opus Restructuring have now been publishing research data on the financial health of the care home sector since 2013, seeking to raise awareness of the escalating social care crisis.

Our most recent report into the residential care sector can be accessed via this link: http://www.opusllp.com/archives/3448

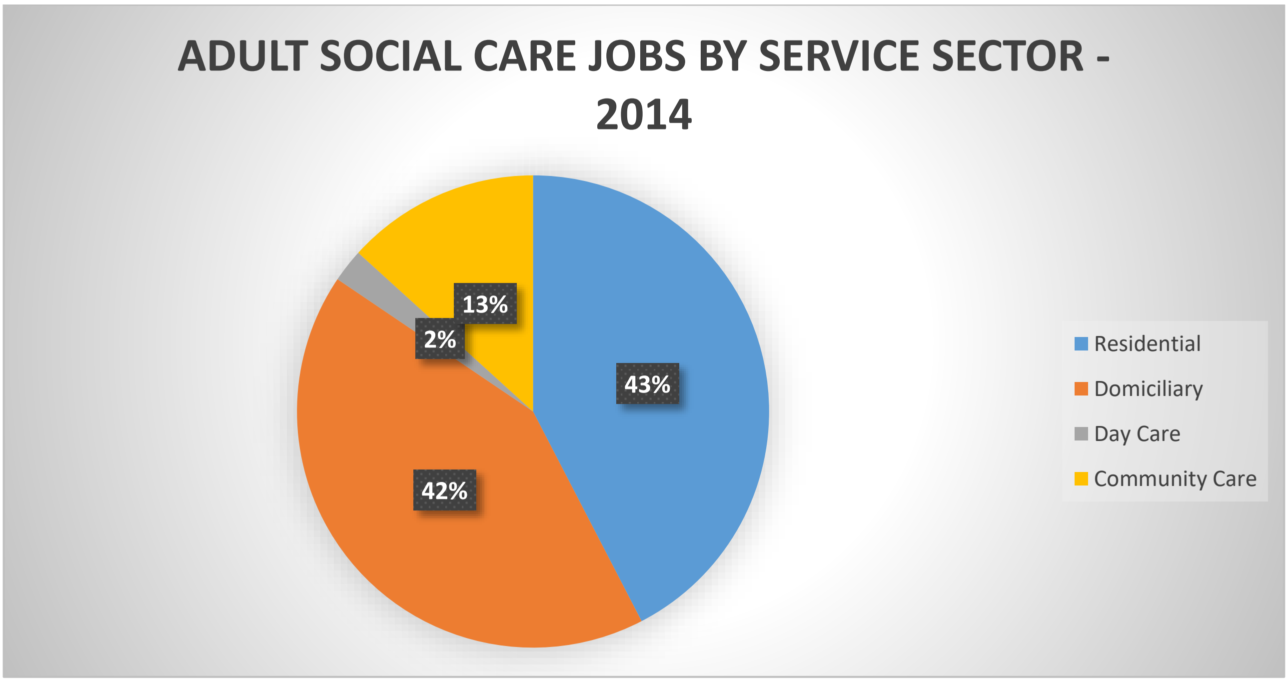
In the autumn of 2016, the BBC commissioned Opus Restructuring to extend its research to cover the domiciliary care sector and some limited elements of this research were used in a BBC Panorama programme broadcast on 20th March 2017 and also in a BBC Wales programme at around the same time. Subsequently, we have expanded our research to include the finances of the three major national chains of care providers and it is this larger data sample that is the subject of this report.

The parlous state of finances in the domiciliary sector were highlighted earlier this month, when one of the largest providers in the South West, Cleeve Link Homecare collapsed, leaving local authorities struggling to find alternative providers for almost 500 elderly and vulnerable clients.

DOMICILIARY CARE WITHIN THE UK ADULT CARE INDUSTRY

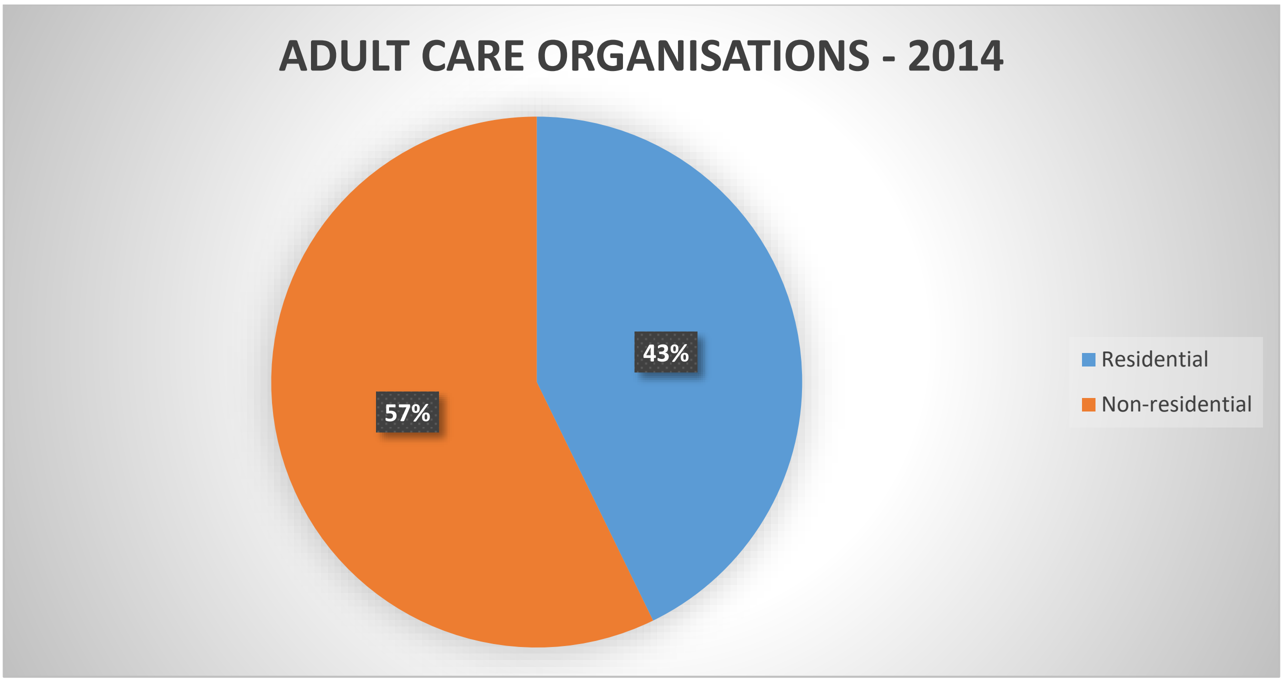
Domiciliary care is only part of a complex, inter-related ecosystem, which seeks to meet the increasing demands of the UK's ageing population. Stresses in any one part of this ecosystem tend to migrate to others, as illustrated by the present 'bed blocking' issue in the NHS, which is caused by a lack of domiciliary and residential care capacity. Equally, a lack of domiciliary resource will tend to push those needing care towards the residential sector and vice versa. In terms of 'users' of adult care services, those receiving domiciliary care are estimated to be approximately 900,000 compared to some 300,000 residents in care homes.

Adult care employed 1.55m people in 2014, split between sectors as follows:



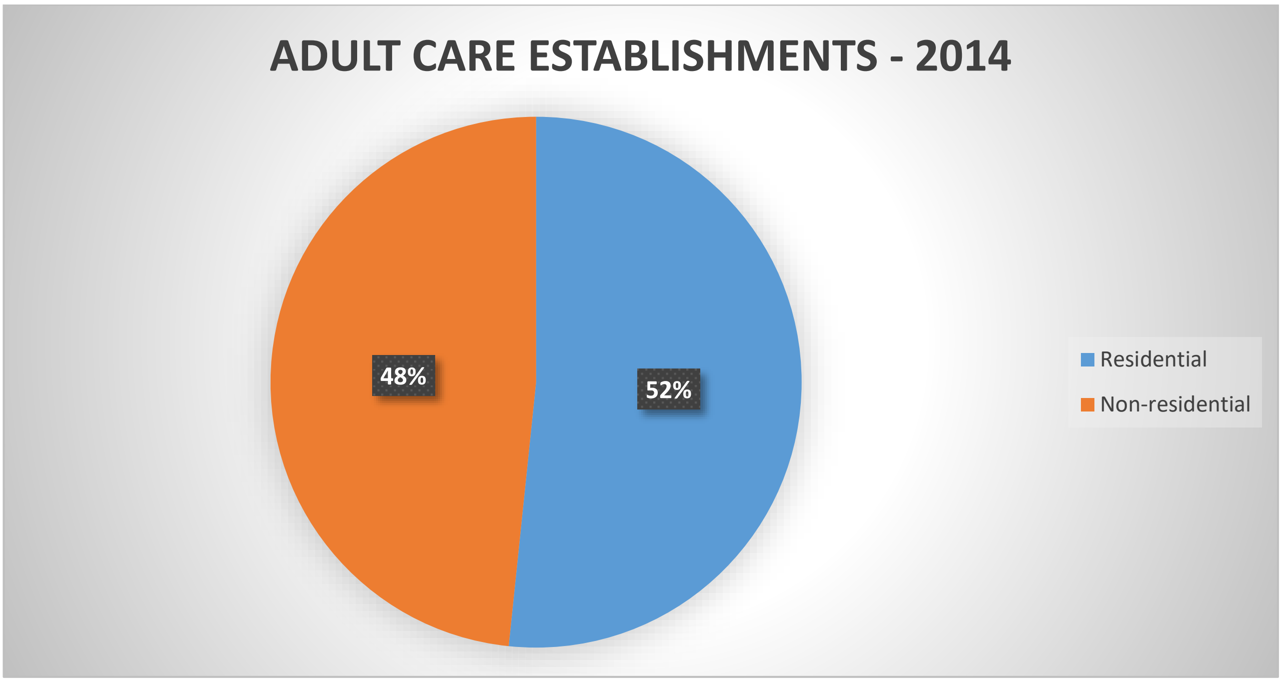
Source: Skills for Care – The Size & Structure of the Adult Social Care Sector & Workforce in England, 2015

In 2014, the adult care industry was comprised of some 18,000 organisations, split as follows:



Source: Skills for Care – The Size & Structure of the Adult Social Care Sector & Workforce in England, 2015

These organisations operated from 39,500 establishments, split as follows:



Source: Skills for Care – The Size & Structure of the Adult Social Care Sector & Workforce in England, 2015

For a detailed analysis of the domiciliary care market in the UK, reference should be made to the report published in 2016 by United Kingdom Homecare Association Ltd. This can be found at this link: https://www.ukhca.co.uk/pdfs/DomiciliaryCareMarketOverview2015.pdf

SCOPE

This report is based on a detailed financial analysis of all of the companies in the UK, which use one of the Standard Industrial Classification ("SIC") codes on their file at Company House indicating that they provide domiciliary and day care of one type or another on a non-residential basis. This data set covers the latest financial statements filed at Companies House by 2,578 companies.

In addition, we have included in our sample the data for three of the UK's largest domiciliary care providers, who do not use any of the appropriate SIC codes in their Companies House filings. These are Mears Care, Everycare (Nestor Primecare) and MiHomeCare.

Many of the largest and best known domiciliary care providers, such as Bluebird Care, Home Instead Senior Care, Heritage Healthcare and Prestige Nursing+Care are in fact franchisors, under whose branding many smaller domiciliary care providers operate. The accounts of these franchisors are not included in our research, but where their franchisees have used the appropriate SIC codes they are included in our data.

Our analysis has been carried out using the Company Watch methodology, which allocates a financial health score (H-Score®) out of a maximum of 100. This is derived from a company's published financial results and quantifies how closely the accounts resemble those of companies which subsequently failed. Companies with an H-Score of 25 or less are placed in what is known as the Warning Area. Not all companies in the Warning Area will fail; however, of the companies that do fail, the vast majority were in the Company Watch Warning Area prior to their collapse.

Because of the delay in filing accounts at Companies House, our research is based on accounts covering a range of accounting dates, mainly ending in 2015 or early 2016. This means that our research does not yet reflect the impact on domiciliary care providers of the introduction of the National Living Wage in April 2016, which has caused a major increase in labour costs for the sector. We discuss the potential effect of this later in this report.

EXECUTIVE SUMMARY

- The sector loses £11.66 per client per year.

- Overall, it is loss making overall, with an average post-tax loss per provider of £4,000. The total losses of the sector are £10.5m. As noted above, this is before the impact of the National Living Wage introduced in April 2016.

- 705 (27%) domiciliary care providers fall within the Company Watch Warning Area.

- 1,181 (45%) domiciliary care providers have H-Scores of 50 or below, indicating a below-par financial position.

- The overall gearing for our sample is 26%, well within accepted financial norms but reflecting the sector's poor profitability which limits the ability to borrow. Total borrowings for the sector are £211m.

- 294 (11%) care home operators are 'zombie' companies, with liabilities greater than their assets. These zombie operators have combined 'negative net equity' of £38m.

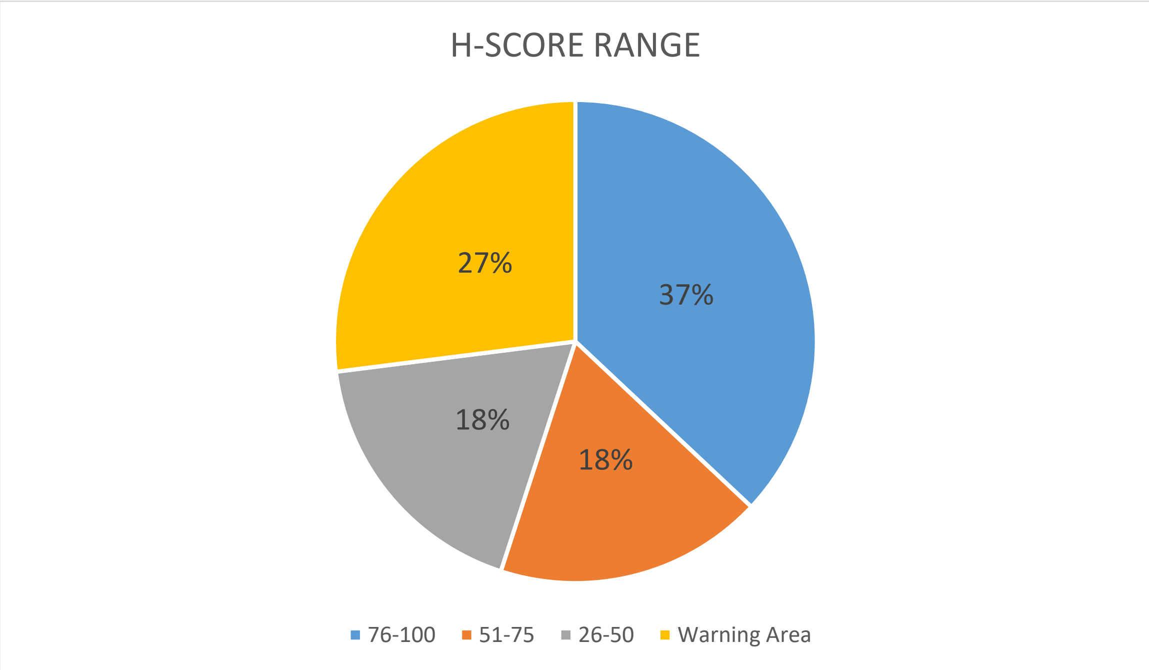
- Investment in the sector has fallen by 14% in the past year, based on average gross assets per provider.

- There are significant regional variations:
    - The South West (36%) and the North West (34%) have the highest percentage of providers in the Warning Area.
    - These regions also have the highest percentage of 'zombie' providers – 17% for the South West and 15% for the North West.
    - Northern Ireland (73 out of 100), Scotland (62) and East Anglia (61) have the strongest financial health ratings, while the three national chains have the weakest (34).

- Scotland has the highest percentage (25%) of loss making providers, East Anglia has the lowest (6%)

FINANCIAL HEALTH ANALYSIS

The latest spectrum of H-Scores for care home operators is as follows:



PROFITABILITY

The average domiciliary care provider makes a post-tax loss of £4,000 per year. This is better than the previous year, when the average loss was £26,000. This improvement was largely the result of a significant turnaround at one of the national chains, Everyday Care.

Eliminating the national operators from the analysis, the smaller operators were marginally profitable, earning a tiny profit after tax of £6,000 a year, a 40% drop from the previous year when the average was a profit of £10,000 per annum.

The latest total annual pre-tax losses for the sector total £10.5m, compared to £58.7m for the previous year. These figures do not yet reflect the effect of the National Living Wage, which we believe will add materially to the sector's losses. In addition, an employment tribunal ruling in 2014 has created a further significant burden by confirming that staff sleeping overnight at clients' houses must be paid the National Living Wage for every hour in their 'sleep in' shift, rather than the lower flat rate shift allowance commonly used in the sector

We discuss these issues later in this report.

THE NATIONAL LIVING WAGE (NLW)

The NLW came into force in April 2016. Those workers aged 25 or over must be paid a minimum of £7.20 per hour, which is 7.5% higher than the previous equivalent National Minimum Wage (NMW) rate of £6.70 per hour. For those workers under the age of 25, the relevant current NMW rate still applies.

The first comprehensive study of the impact on the care sector of this change in pay rates was carried out by the Resolution Foundation and published in late August 2016. Based on the pay data for 80,000 employees of more than 2,000 care providers, it found that the overall pay bill had risen by more than twice that needed to meet the new NLW.

The study suggests that 57% of frontline workers (54% of all) have benefited directly from the £7.20 minimum with an average pay rise of 9.2%. This includes 83% of those aged under 25 who are now receiving £7.20 or more, even though it is not required by law. The overall pay bill for those employees surveyed had risen by 6.9%.

We have found no comprehensive data for the overall labour costs for the domiciliary care sector. However, our latest residential care report estimated that the impact of the introduction of the NLW on that sector was likely to be a cost increase of over £400m in the first year, rising further as the hourly rate increases in future years.

The domiciliary care sector employs broadly the same number of staff as the residential care sector. It may be that total labour costs are lower for domiciliary care workers; never the less it remains the case that there will be a very significant potential increase in the sector's losses unless providers are able to negotiate higher fees, particularly for local authority funded clients. Under present budget constraints, that seems highly unlikely.

SLEEP IN SHIFT PAYMENTS

An Industrial Tribunal ruling in 2014 has presented the social care sector with a further major challenge. The decision held that care workers sleeping overnight at clients' homes or in care homes must be paid the National Living Wage for every hour in their shift, rather than the lower flat rate shift allowance which most providers in the sector had previously paid. Estimates of the impact vary from a Government Minister's statement that the extra cost might amount to £200m to industry experts who believe this figure (including back pay) might be three times higher.

This deeply worrying issue was analysed in this article in the Guardian:

https://www.theguardian.com/society/2017/feb/08/social-care-sleep-in-shifts-living-wage?utm_source=Publicate&utm_medium=email&utm_content=Social+care+is+on+the+brink.+This+new+nightmare+might+push+it+over+the+edge+%7C+David+Brindle&utm_campaign=Weekly+Brief+-+13+February+2017

ZOMBIE COMPANIES

We define a zombie company for the purposes of this report as being one where its total liabilities exceed its total assets in its latest published accounts. Based on our research, there are 294 domiciliary providers in the UK that fit this definition, amounting to 11% of the total. Their total 'negative equity' was £38m. This is broadly unchanged since a year previously, when there were 291 zombie domiciliary providers with a combined shortfall of £40m.

ASSET PROFILES

The average net worth of providers is £314,000, confirming how small the players in this sector are, which makes them vulnerable to pricing pressures from local authorities and likely to have limited reserves to withstand any sustained losses. A year ago the average net worth was £318,000 so that the sector appears to be losing value, even if it is at a marginal rate.

Average gross assets are also reducing, indicating lower investment in the sector. The average total assets per operator is now £538,000, compared to £625,000 a year ago. This is a substantial fall of 14%.

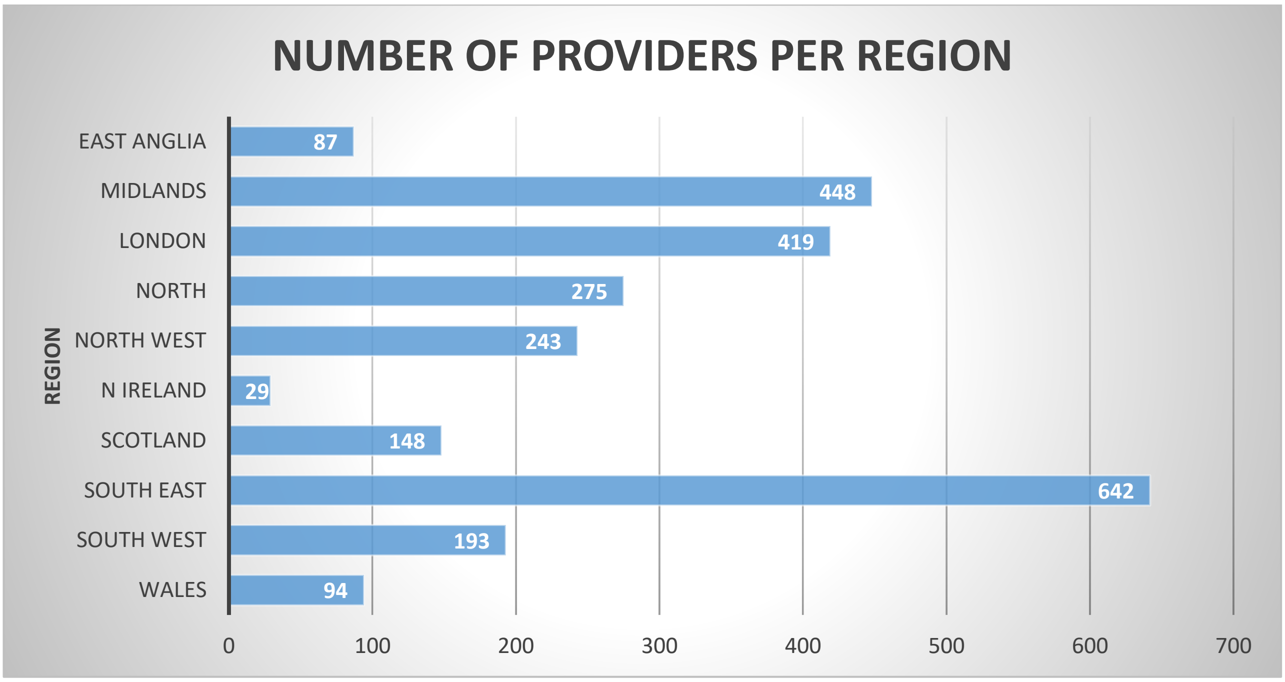
BORROWING & GEARING LEVELS

Borrowing is not a significant element in the business model of most UK domiciliary care providers, although the national chains do carry higher debt levels. Gearing across the sector is 26%. If the national chains are excluded, gearing falls to just 10%. The sector as a whole borrows £211m, of which the national chains are responsible for £98m.

REGIONAL VARIATIONS

We have also analysed our data sample by region within the UK. We have allocated providers to regions based on the company's registered office. There will be some instances where a provider may be located in one part of the country but have a registered office with a professional adviser elsewhere and other cases with slightly bigger chains where a provider's units are based more widely than where their registered office is located. Never the less, we believe this geographical break down to be sufficiently accurate to justify its inclusion.

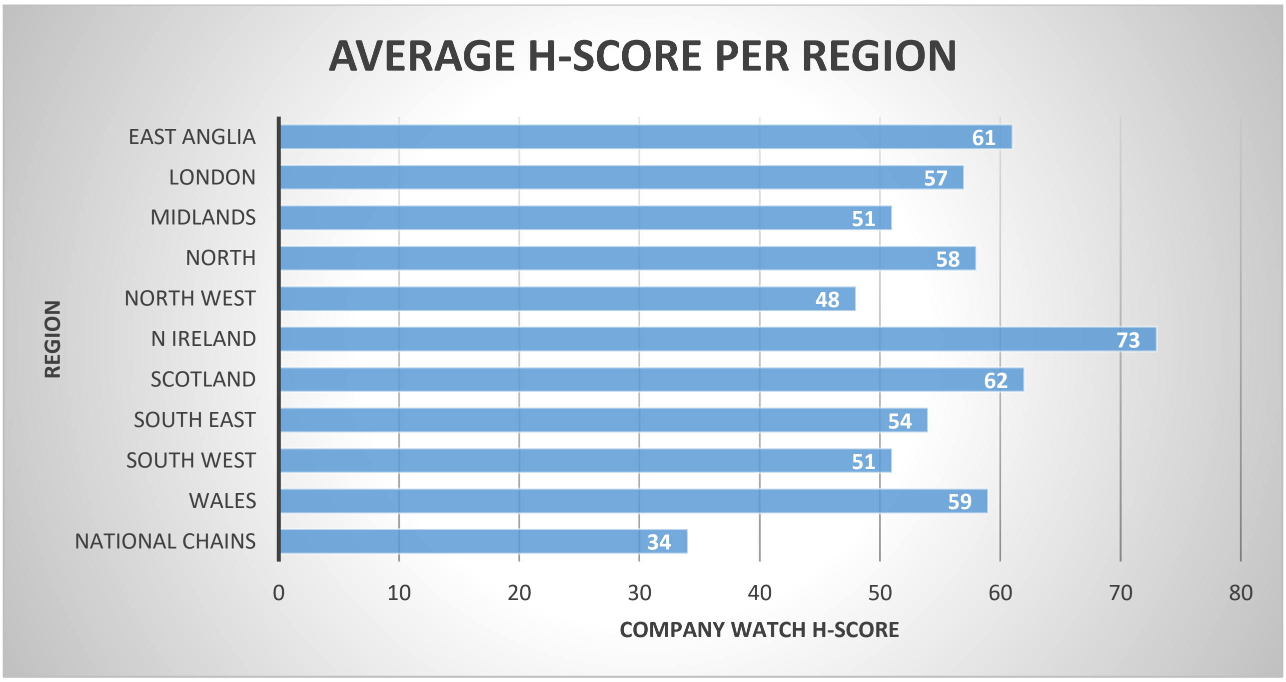
The number of domiciliary care providers per region is as follows:



There are also three national chains with multiple operating units across the UK.

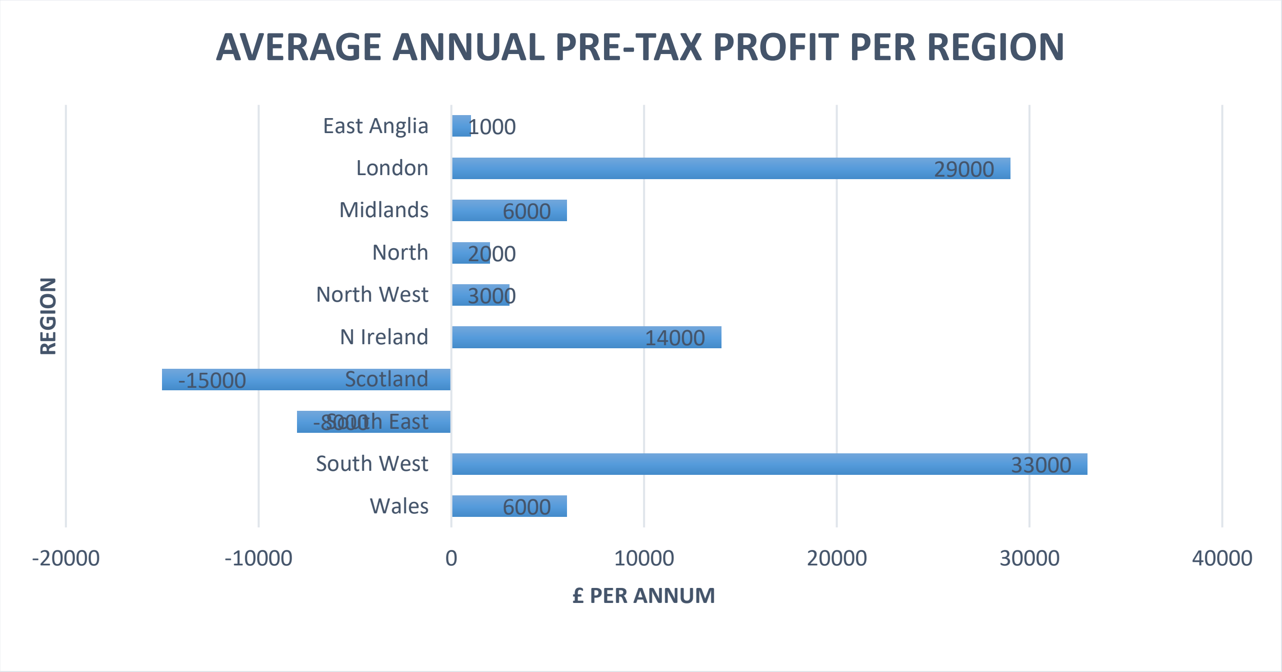
Regional Financial Health

There are wide variations between regions when overall financial health is compared. Northern Ireland has the most financially secure operators with an average H-Score of 73, while the North West have the equal lowest average H-Score of 48. The three national chains have an average H-Score of just 34. The comparative average Company Watch H-Score per region is as follows:



Regional Profitability

Profitability also varies widely between the regions. The most profitable region is the South West where on average providers make an annual post-tax profit of £33,000. The next most profitable region is London at £29,000 per annum and the worst is Scotland where the overall average loss per provider is £15,000. The full analysis is here:



CONCLUSIONS & REFLECTIONS

The overall picture of the UK's domiciliary care sector is one of negligible or negative profitability, too many providers in a vulnerable financial position and a worrying number of 'zombie' providers. Some regional variations are a matter of concern. Pressure will mount for more capacity to deal with the predicted rise in the number of people needing care. Unless significantly more public funding over and above that announced in the Chancellor's latest Budget is made available, the risk is that more and more domiciliary providers will leave the market altogether because the returns available do not justify the risk, compounding what is already sustained pressure on social care. Equally, the present financial crisis in residential care and the NHS can only have the effect of increasing the demand for home care options for those needing care and support.