StewartBrown

Integrity + Quality + Clarity

AGED CARE FINANCIAL PERFORMANCE SURVEY

The StewartBrown Aged Care Financial Performance Survey incorporates detailed financial and supporting data from over 825 residential aged care facilities and 440 home care programs across Australia. The quarterly survey is the largest benchmark within the aged care sector and provides an invaluable insight into the trends and drivers of financial performance at the sector level and at the facility or program level.

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EXECUTIVE SUMMARY
SEPTEMBER 2016 EBIT

Average EBIT per client per day

$(6.02)

Band 1 Average EBIT - $(6.02) per client per day

[June 2016 - $(3.28) per client per day]

$(0.17)

Band 2 Average EBIT - $(0.17) per client per day

[June 2016 - $1.98 per client per day]

$5.75

Band 3 Average EBIT $5.75 per client per day

[June 2016 - $3.27per client per day]

$14.92

Band 4 Average EBIT $14.92 per client per day

[June 2016 - $18.26 per client per day]

EXECUTIVE SUMMARY
SEPTEMBER 2016
PACKAGE UTILISATION

Average Package Utilisation

66.5% Band 1 Average Package utilisation 66.5%

79.7% Band 2 Average Package utilisation 79.7%

85.8% Band 3 Average Package utilisation 85.8%

90.0% Band 4 Average Package utilisation 90.0%

EXECUTIVE SUMMARY
SEPTEMBER 2016
REVENUE UTILISATION

Average Revenue Utilisation

58.1% Band 1 Average Revenue Utilisation 58.1% [June 2016 - 83.4%]

60.1% Band 2 Average Revenue utilisation 60.1% [June 2016 - 89.1%]

70.6% Band 3 Average Revenue utilisation 70.6% [June 2016 - 82.9%]

65.4% Band 4 Average Revenue utilisation 65.4% [June 2016 - 87.2%]

EXECUTIVE SUMMARY
SEPTEMBER 2016
MARGIN ON DIRECT SERVICES

Average Margin on Direct Service Income

4.7% Band 1 Average Margin Direct Service Income 4.7%

19.0% Band 2 Average Margin Direct Service Income 19.0%

28.0% Band 3 Average Margin Direct Service Income 28.0%

24.3% Band 4 Average Margin Direct Service Income 24.3%

INTRODUCTION

Another year begins, and with it comes further reform for home care package providers and their clients. The home care sector moves into a year of significant change and over the next 12 months or so we are a likely to see a shift in the culture and behaviour of home care providers, driven primarily by emerging mores of evolving consumer demand. In fact if providers do not change the way they approach, market and therefore operate their services, they may find themselves losing consumers.

The year will also bring a change to the way we look at home care from a business perspective, including benchmarking. We have taken feedback from providers and have now aligned our revenue bands so that they better reflect the package levels. This has one consequence in that there are not many programs in Band 1, as the reality is that there are not too many Level 1 packages in the marketplace and this is unlikely to change. However the distribution of programs across the other bands are relatively even and represent the distribution of packages in the survey.

Home Care Package Income Bands

1. **Band 1 less than $30 per day**
   Provider income under $30 per client per day
2. **Band 2 between $30 <> $50 per day**
   Provider income between $30 and $50 per client per day
3. **Band 3 between $50 <> $100 per day**
   Provider income between $50 and $100 per client per day
4. **Band 4 over $100 per day**
   Provider income over $100 per client per day

Over the coming year we will also be adding some metrics to our benchmarks as well as removing one or two.

From the March 2017 quarter we will be adding two new metrics being package retention and growth rates. For providers, these KPIs will be increasingly important. Firstly it will be important that at a minimum, package numbers are maintained (retention rate) so that there is no diminution in the recovery rate of fixed costs. Secondly, the ability to grow the number of packages will assist in maintaining or increasing overall profitability, particularly as margins are likely to continue to decline as competition increases. Increasing volume will be the key in gaining economies of scale in areas such as administration as well as justifying investment in technologies that will also provide long term efficiencies.

These two metrics will replace the current package utilisation rate. This will no longer be a relevant measure as providers will no longer have a package allocation against which we can measure "occupancy".

The other metric that we will be starting to provide is in relation to staff productivity. Our preference is to collect data in relation to Billable hours and compare this to the total hours paid to staff which we already collect. Our ability to do this will of course rely on our benchmark participants recording and collecting this information themselves. This measure will become vitally important to home care providers moving forward to ensure that their business remains viable. As a public accounting practice billable hours is certainly one of our key KPIs, and as home care providers become more commercial in their approach to business, productivity will need to be one of their key performance indicators.

We encourage all home care providers to start putting systems in place to be able to collect, record and monitor the billable hours of their service staff, and case management staff for that matter, and set targets for the staff to meet. In fact these productivity rates should be built into the costings of the services upon which the selling prices are based.

If any provider would like assistance in setting up their systems or building these metrics into their costings and management reports, please contact David Sinclair or Tracy Thomas at our office.

This report covers the three month period to September 2016 which means that providers and their clients should have seen a benefit from increased subsidy rates and in the latter part of the quarter will have seen an increase in the amounts that can be charged to clients. Of course this may not necessarily affect the bottom line unless clients actually spend those funds. As we will see in the report, there has been a significant jump in the amount of unspent funds from where they were at June 2016.

This continues to be one of the areas that providers need to address in their business models moving forward.

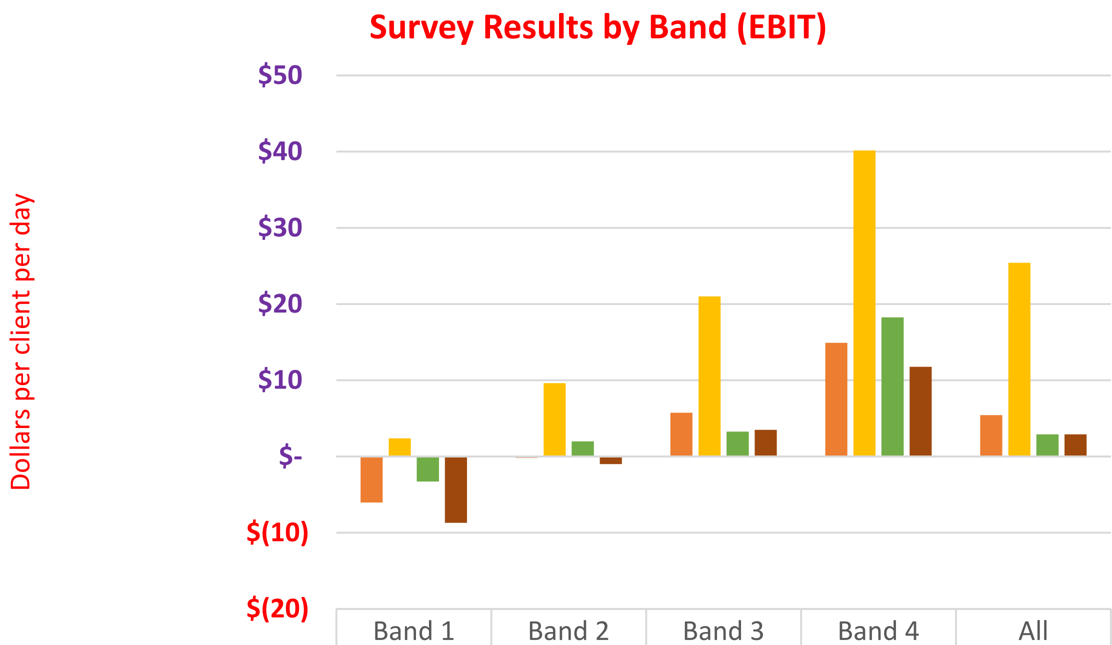
This report provides an update for providers and the industry. We will start to provide some trend data for the December 2016 survey comparing the results to this quarter but also to the previous year. We have re-sorted the June 2016 data to align with these new income bands and in the interim period we will also go back and readjust the previous three quarter’s data so that some trend comparisons can be made.

RESULTS IN DETAIL

Profitability

If we are to compare the results for September against those that were reported against June 2016 then there has been a general decline across the bands. However if we compare them to the June results adjusted for the new band parameters then there is a slightly different story as shown in the graph below.

Figure 1 – EBIT per client per day compared to June 2016



	Band 1	Band 2	Band 3	Band 4	All
Average	$(6.02)	$(0.17)	$5.75	$14.92	$5.44
Top Quartile	$2.38	$9.64	$21.01	$40.15	$25.41
June 2016 (Unadjusted)	$(3.28)	$1.98	$3.27	$18.26	$2.91
June 2016 (Adjusted)	$(8.70)	$(0.99)	$3.51	$11.77	$2.91

So the results have in fact improved since June 2016, which is normally the case in the September quarter. The average result across all packages in the survey has increased from $2.91 per client per day to an average of $5.44 per client per day.

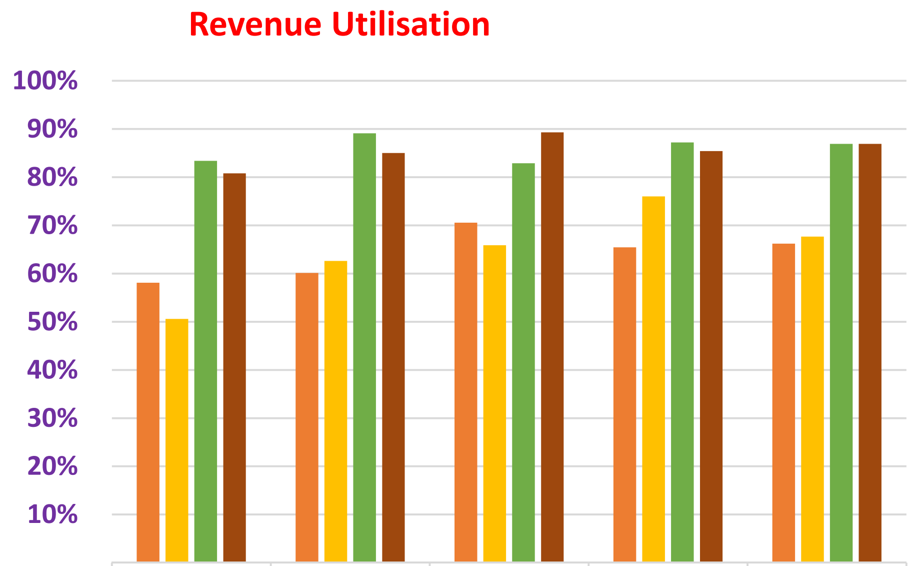
The data displayed in the above graph as well as in a number of the following graphs compares the September data to both the June 2016 data as reported in our June survey as well as against the June data adjusted for the new income bands used for this financial year. Moving forward we will only be comparing against those adjusted figures.

In fact, given what we suspect is a lack of proper accounting for unspent funds in the September quarter, the profit for the current year could in fact be somewhat understated. Given the increased levels of unspent funds reported it the September quarter, we are of the view that a large number of providers have not yet reconciled their unspent funds balances and brought the funds to account for those clients who have left the system since June 2016.

Unspent Funds

The inverse of the unspent funds ratio is what we call the revenue utilisation rate – the ratio of total revenue charged to clients compared to total revenue available in a package from client fees and government subsidies.

Figure 2 – Revenue utilisation rates



	Band 1	Band 2	Band 3	Band 4	All
Average	58%	60%	71%	65%	66%
Top Quartile	51%	63%	66%	76%	68%
June 2016 (Unadjusted)	83%	89%	83%	87%	87%
June 2016 (Adjusted)	81%	85%	89%	85%	87%

As can be seen in the table and graph above, there has been a significant reduction in the unspent funds ratios across the survey and we can only come to the conclusion that a large reason for this is that the unspent balances for those people that have moved on from providers during the three months to September have not yet been brought to account as income.

If this is not the case, then the sector is heading for some trouble come February 2017.

We encourage all providers to reconcile their unspent funds on a monthly basis so that they can be properly monitored at all levels of management as these funds will be lost to providers moving forward. We saw at June that the average level of unspent funds across the survey was 13%. At the same time, the average profit margin across all packages was only 4.4%. This means that if providers were relying on the unspent funds being brought to account as revenue when clients left to underpin their profits then this model will not be sustainable moving forward.

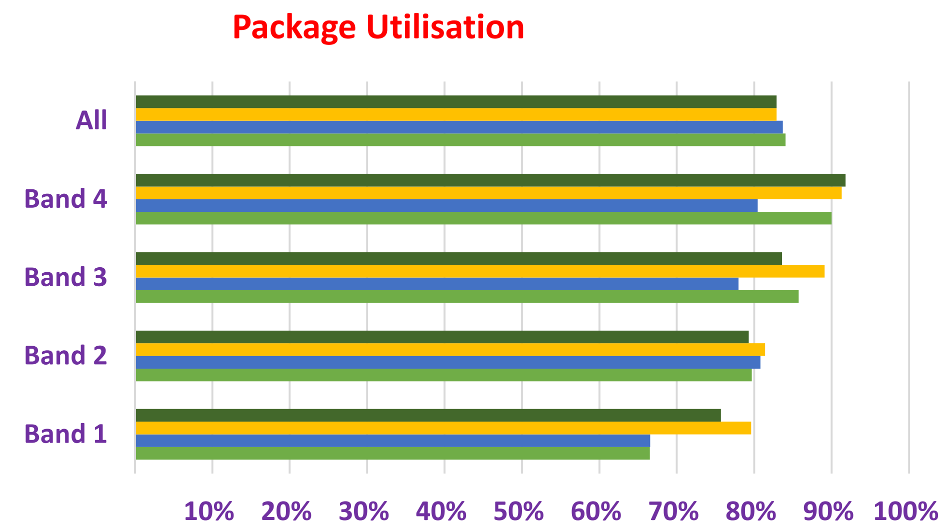
Providers must find a way to change their business model to ensure that the majority of packaged funds are utilised by their clients, preferably with services rather than goods or other third party purchases.

Package Utilisation

We continue to measure package utilisation or occupancy while providers have an allocation of packages. This measure will become irrelevant in the future once the system moves to allocating a package to a client rather than a provider.

We have seen some decline in package utilisation rates since June at some individual package levels, however the average across all packages has increased by a marginal 1%. Level 1 packages continue to be a disappointment and are becoming increasingly difficult for providers to fill as clients it would appear would rather receive these services using other programs such as the Commonwealth Home Support Program.

Figure 3 – Package Utilisation rates (occupancy levels)



	Band 1	Band 2	Band 3	Band 4	All
June 2016 (Adjusted)	76%	79%	84%	92%	83%
June 2016 (Unadjusted)	80%	81%	89%	91%	83%
Top Quartile	67%	81%	78%	80%	84%
Average	67%	80%	86%	90%	84%

Moving forward it will be increasingly important for providers to set "sales targets" to ensure that, at the very least, current package numbers are maintained, but to encourage growth in the number of packages supplied by the organisation. It is through this growth in package numbers that providers will help to ensure the ongoing viability of the service.

Providers need to put in place a business model that will support a market driven approach, something that many providers have not yet done. The idea that when a client moves from an existing package, that the ability to recover fixed costs has now been diminished unless they are replaced with another client is only now coming into focus for many providers – and there are only two months to go until the start of this reform. Providers must act now and part of that process will be to put in place a strategy for growth and a marketing and sales plan – including setting sales targets.

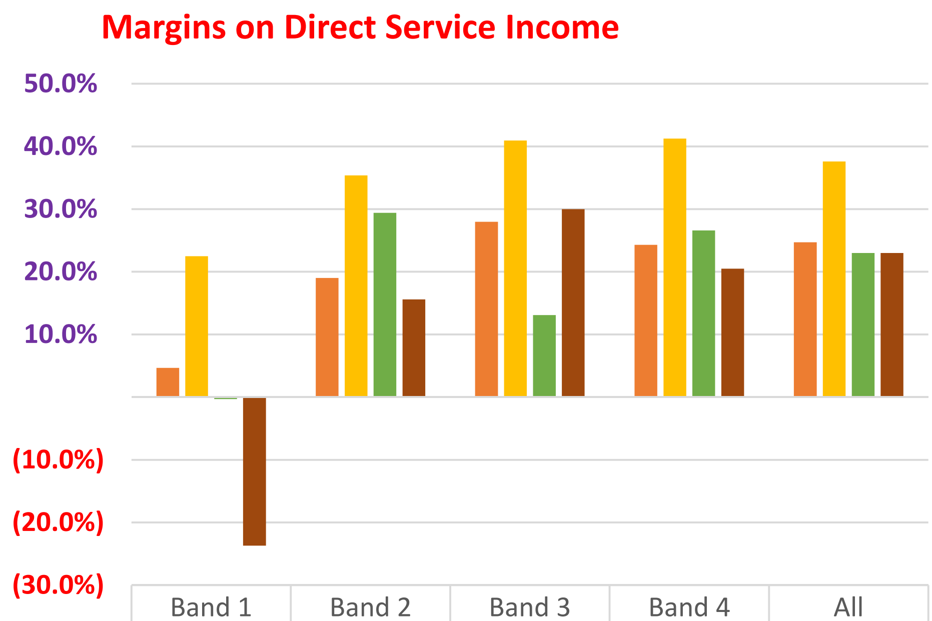
Direct Services Margins

As with the bottom line results we have seen some improvement in margins charged on the direct services provided to clients. With the exception of Level 1 Packages, we are also seeing more consistency across package levels in relation to margins with an average of 24.7% across all packages which is a slight increase on the June 2016 average of 23%.

The margins on direct services will need to be maintained at these levels, and preferably increased for a number of reasons including:

- Margins should be sufficient to make a significant contribution to recover fixed costs including a large proportion of administration and support costs
- Selling prices need to be set at a level that assists in utilising more of the available package funds and recovering all of the costs involved in servicing the package

Figure 4 – Margins on direct services



	Band 1	Band 2	Band 3	Band 4	All
Average	4.7%	19.0%	28.0%	24.3%	24.7%
Top Quartile	22.5%	35.4%	40.9%	41.2%	37.6%
June 2016 (Unadjusted)	(0.3%)	29.4%	13.1%	26.6%	23.0%
June 2016 (Adjusted)	(23.7%)	15.6%	30.0%	20.5%	23.0%

More providers are looking at how they charge their clients for package administration and as part of their overall pricing strategies they are now looking to minimise the package administration fee and recover more of their administration costs through a higher margin on direct services.

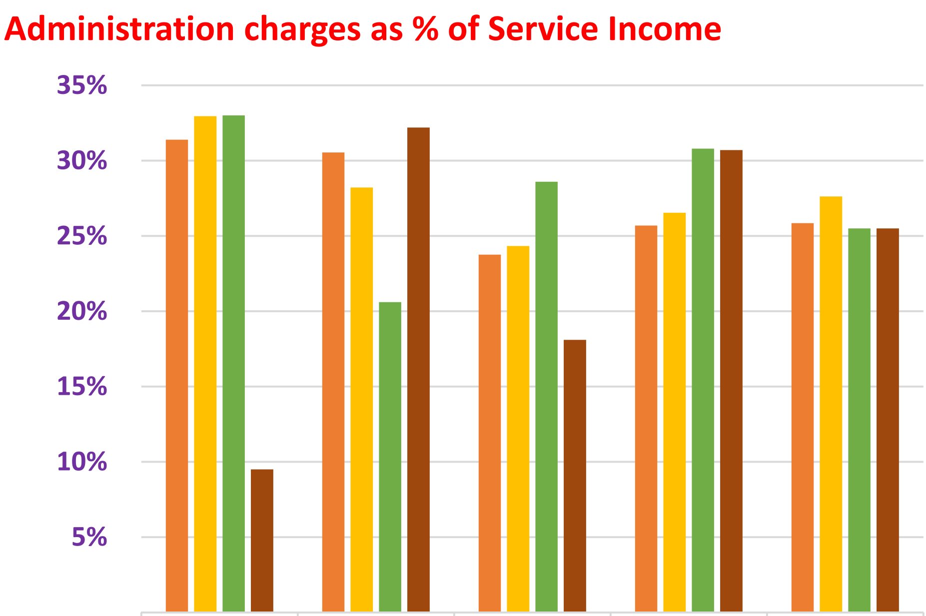
This will be a balancing act for providers and will need to be part of an overall business model and marketing strategy rather than taking the view of "we will just do what the provider down the road does". A pricing strategy, including how administration fees are recovered needs to be part of how providers sell themselves to clients.

Administration Fees

In our June survey we reported that a number of providers were examining the way they were charging their administration fees and in speaking to providers, that continues to be the case as they re-examine their overall pricing and sales strategy.

What the figures do show us is that across all packages the administration fee remains at 2016 levels when expressed as a proportion of "services revenue" being the combination of the charges to clients for both direct and brokered services. This ratio for the three months to September 2016 was and average of 25.8% compared to an overall average of 25.5% for the 2016 financial year. The top quartile average across all packages in the survey was 27.6%.

Figure 5 – Administration fees as expresses as a % of service income (direct services and brokered services)



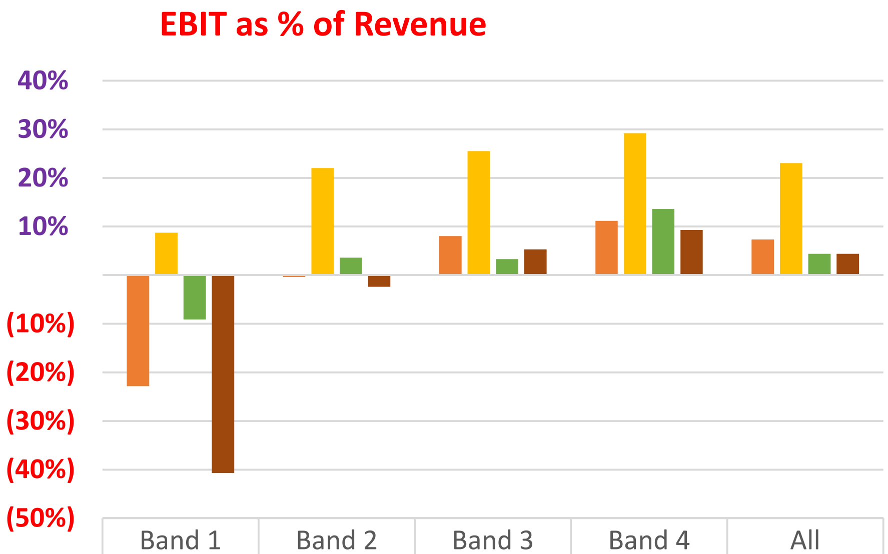
	Band 1	Band 2	Band 3	Band 4	All
Average	31.4%	30.5%	23.8%	25.7%	25.8%
Top Quartile	32.9%	28.2%	24.3%	26.5%	27.6%
June 2016 (Unadjusted)	33.0%	20.6%	28.6%	30.8%	25.5%
June 2016 (Adjusted)	9.5%	32.2%	18.1%	30.7%	25.5%

What we do know is that the amount being charged for administration of packages is going nowhere near recovering the actual administration costs. Margins range from negative 116% for Band 1 packages to negative 38.5% for Band 4 packages. Even for the top quartile groups, the margins range from negative 62.6% (Band 1) to negative 11.4% (Band 2).

Overall Profit Margin

As might be expected with the direct services margins contributing significantly to recovering administration and support costs, the overall margins are somewhat less than the margins being achieved on those direct services.

Figure 6 – Margins on total revenue



	Band 1	Band 2	Band 3	Band 4	All
Average	(22.8%)	(0.4%)	8.0%	11.2%	7.4%
Top Quartile	8.7%	22.0%	25.5%	29.2%	23.1%
June 2016 (Unadjusted)	(9.1%)	3.6%	3.3%	13.6%	4.4%
June 2016 (Adjusted)	(40.7%)	(2.4%)	5.3%	9.3%	4.4%

The overall margins now being achieved for low care packages are in the negative and the margins for high care packages are positive although they are not what they were prior to the introduction of CDC. Across all packages in the survey the average margin is 7.4%, which is slightly better than at June 2016 but can be expected to decline over coming months as unspent funds start to be returned to clients and government and market pressures put further pressure on pricing.

It is critical for providers to better understand the costs of providing their clients a range of services and then pricing those services accordingly. If the selling price is not competitive then the provider must look at why they can't provide the service profitably at a similar price to their competitors. We would have thought that providers might have undertaken this exercise when implementing CDC and to be fair we saw that many providers did in fact do that. However, we are now seeing many providers undergoing a more detailed cost analysis so that they can better understand where efficiency gains and cost savings need to be made in order to become more competitive or to improve their margins on their existing price/service structures. This will be a critical process in the ongoing viability and sustainability of the home care business of providers.

If you have not already started this process, it is not too late. If you need some assistance in the process please contact one of our advisers.

GETTING YOUR BUSINESS READY FOR THE REFORMS

What do we know?

- Returns are lower now than prior to CDC
- Unspent fund balances are increasing (averaging over 15%)
- Administration costs are not fully recovered through an administration fee to clients
- Low care packages are becoming increasingly difficult to fill and are becoming less profitable
- Unspent funds will be returned to clients and government post February 2017
- Packages will no longer be allocated to providers
- Unused packages will go into the national pool
- Once a client leaves the system their package goes into the national pool

Providers need to put in place a new business model including strategies for marketing, pricing, systems and KPIs which will drive a change in overall culture and market behaviour.

Marketing Strategy

- Brand strength increasingly important
- Aged Care is taking on retail aspects (brand, product, placement, price & positioning)
- Exploit the continuum of care to 'capture' clients
- Commodity, service or price differentiation approach
- Client purchasing behaviour poorly understood
- Acquisitions & partnerships key
- Setting sales targets

Pricing Strategy

- Defined activities of service
- Identified cost elements
- Established unit costs and selling price of each activity of service
- Determined method of recovering coordination and case management
- Determined method of recovery of administration costs
- Add margin and determine retail price

Systems

- Providers must invest in systems to survive
- Must drive efficiency, reduce admin burden and duplication of data
- There are a number of specialist software packages (However there needs to be integration with existing systems)
- For many smaller providers a band aid approach using spreadsheets is common practice
- Which system is to be used for certain tasks?
  - Payments to creditors
  - Time and attendance
  - Client billing

These things will drive a change in the overall culture and behaviour of providers. They will need to be more commercially aware and be sales driven. This might include changing the way some staff are remunerated so that there is performance element to their remuneration based on achieving certain sales targets or meeting other KPIs.

Moving Forward

Providers will need to re-examine the drivers of profitability within their business and look at monitoring and measuring new metrics.

- There will be ⑤ very important KPIs post February 2017
    1. Client care plan engagement time
    2. Package retention and growth rates
    3. Revenue utilisation
    4. Direct care cost % to revenue
    5. Employee productivity
- Systems need to be geared to collect this information at more than one level of the business

Management information systems will need to be able to provide this information to management and staff on a regular basis so that they can react accordingly to either rectify an adverse trend.

StewartBrown Aged Care Executive Team

Stuart Hutcheon

Managing Partner

Stuart Hutcheon is the firm's Managing Partner and the head of our Audit & Assurance Division, and also provides consulting services to a diverse client base. He has had considerable experience with both commercial and not-for-profit organisations. This experience covers all areas of professional services including auditing, management accounting, budgeting, salary packaging and FBT advice. Stuart has been involved in providing professional services to the aged care and community care industry sectors for over 20 years.

Grant Corderoy

Senior Partner

Grant Corderoy is the head of the Aged and Community Care and Business Consulting Division. Grant first established the Aged Care Financial Performance Survey in 1995. He specialises in a range of services for his clients including undertaking complex accounting assignments, business performance reviews, organisation and governance reviews, system reviews, management consulting, strategic planning and general business advice. He also has considerable experience in advising clients on the sale and purchases of businesses, business valuations and due diligence.

Patrick Reid

Director

Patrick has recently joined StewartBrown in the position of Director - Aged Care, Community and Disability after serving as CEO of LASA. As an experienced CEO, board director, business owner and executive with more than 20 years' success in business, association management and lobbying, Patrick possesses a proven track record in business, leadership, change management and advocacy. Patrick has highly developed financial, commercial, negotiation and management skills.

David Sinclair

Director

David Sinclair has been with the firm for over 20 years and has been involved in the Aged Care Financial Performance Survey for the duration of that service and now heads the team undertaking the survey. David is also heavily involved in consulting assignments for aged care and community service clients including strategic planning, financial modelling, budgeting and governance reviews.

Tracy Thomas

Consulting Manager

Tracy is a Chartered Accountant with six years post qualification experience. She has a diverse background having worked in audit and assurance, for the regulator of private health insurance and for a private health insurance company. Since joining StewartBrown she has worked with several providers of residential aged care and home care and produced the Aged Care Financial Performance Survey Corporate Administration Report and Listed Providers Analysis for year ended June 2016. She specialises in data analysis and financial modelling.

StewartBrown - Our Knowledge is your success

StewartBrown, Chartered Accountants, was established in 1939 and is one of the leading boutique accountancy firms in Australia combining a full range of professional services with varied corporate assignments. Our professional mission statement is "*we deliver service beyond numbers*", which reflects the commitment to helping our extensive range of clients to achieve their financial goals.

We offer a depth of technical knowledge and varied professional experience, with many of our senior staff now having well over 10 years' of service with the firm, resulting in our clients benefitting from continuity and accountants who really understand their business.

What a boutique firm offers

Whilst StewartBrown provides a range of professional services, our "point of difference" is our ability to engage in assignments of a complex nature by providing a varied mix of experience and corporate skills. Examples of recent consulting assignments include:-

- ✓ Contract accounting
- ✓ Payroll processing and billing processing
- ✓ Financial modelling and unit costing analysis
- ✓ Strategic planning facilitation
- ✓ ITSC Project management
- ✓ Governance reviews
- ✓ Organisation restructures
- ✓ Risk management reviews
- ✓ Due diligence
- ✓ Work-flow building design
- ✓ FBT and GST reviews
- ✓ Detailed forecasting modelling

Audit and assurance services

Complementing our consulting services is our dynamic Audit division. StewartBrown adopts a risk based audit approach which is performed strictly in accordance with Australian Auditing Standards. Our engagements involve a detailed analysis of the client's business and systems of internal control to ensure we fully understand how the client operates and identify areas that pose the greatest risk of being materially misstated in the financial statements. Our detailed testing procedures are then tailored to meet the risks identified and also ensure an efficient and effective audit is performed.

What we offer our audit clients are a mix of experience and knowledge well beyond that of most other firms. Our audit staff all have regular exposure to consulting and secondment assignments which significantly enhances the "value add" we bring to our audit clients.

Specialty in the aged care, community and disability sectors

StewartBrown is widely regarded as being a leading specialist within the aged care, community and disability sectors. Our client base includes many large national providers in addition to independent stand-alone providers, faith-based and community providers, culturally specific providers, as well as government and statutory bodies.

Our commitment to these important social sectors each year involve 30+ plus speaking engagements at Conferences, sector briefings, workshops, department briefings, organisation presentations and community consultations.

Integrity + Quality + Clarity

These terms which appear on our logo are more than aspirations, they appear for a very important reason - they encapsulate the professional standards that we strive to continually maintain and ensure best practice.

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