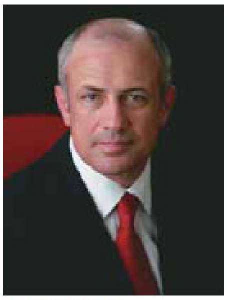
After EBITDA?

James Underwood discusses how the EBITDA measure should be used and applied in aged care.

The big challenge when considering EBITDA (earnings before interest, taxation, depreciation and amortisation) measures in aged care is deciding what to do with accommodation bonds. Some EBITDA reports show the interest received on bond holdings. Others don't. In many cases, the bonds are spent on building developments so there is no interest income, just a reduction in interest that would have been paid on debt.

All residentialcare services receive accommodation payments for all of their residents. These payments are: supplements for supported residents; accommodation charges; or bonds. We almost always show the first two of these payments in EBITDA, so what do we do about the bonds? Consider the following scenarios.



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SCENARIO ONE

There are two similar-sized aged care services in similar localities with similar rooms. If one service has an EBITDA of $10,000 per place each year and the other makes $5,000 per place, which is the financially better performing service? Which should be used as a benchmark? The answer is: you do not know.

Why? Because you don't know how much is being held in accommodation bonds at the two services. When bonds and bond income are not included in EBITDA calculations, a service that takes a high level of accommodation charges and supplements instead of bonds may show a higher EBITDA, despite having poorer financial performance.

SCENARIO TWO

Two low care services are for sale. Both are located in a capital city. Both are a similar age. Both have 60 places. Both are in similar socio-economic regions. Both have a price tag of $10 million. Both have the same EBITDA and show no income from bond holdings. The accrued annual leave, long service leave and accommodation bond balances will transfer to the buyer of both.

One service holds 45 bonds at an average of $180,000, or $8.1 million in total. The other holds just 25 bonds at an average of $120,000, or $3 million in total. Which service would you buy?

SCENARIO THREE

Two identical 60-place low care services are based in similar areas, where houses regularly sell for $600,000 or more. In both facilities, 70 per cent of residents pay bonds and they both market new bonds at an average of $250,000. Home A, however, wants to increase its capital earnings quickly to meet the cost of building an 80-place high care extension without having to borrow significantly.

Accordingly, it offers to discount residents' fees by $10 a day (or $3,650 a year) for every extra $100,000 paid over the $250,000 'base' bond. Residents are encouraged to speak with financial advisers and many of them actively negotiate higher bonds on behalf of residents because they can then receive a higher pension and lower income-tested fees after their homes are sold.

Home A now holds $4 million more in bonds than Home B, but it receives $146,000 less in fees each year. The owner of Home A thinks of this as an effective rate of 3.65 per cent per annum on funds, which is much lower than current borrowing rates. However, on an EBITDA analysis where fee income is shown but bonds and bond income are not shown, Home B has superior performance by $146,000 a year.

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SCENARIO FOUR

EBITDA normally includes all fees including extra services fees. Home X and Home Y are otherwise identical and both charge an extra services amount (ESA) of $50 a day. Both have occupancy levels of 86 per cent.

Home Y offers new residents the opportunity to pay higher bonds and have much or all of their ESA waived. This proves popular and Home Y's occupancy goes up, but its average fee income per person goes down. The net effect is 'break-even'. After 12 months, the EBITDA of both homes is still identical, but home Y now has $5 million extra in bonds.

IS EBITDA GOOD OR BAD?

There are some very useful parts to EBITDA. Its greatest strength is the way it focuses on the return of a service before considering how the service is financed. If you have two otherwise identical services but one is owned debt-free and the other is paying off capital and interest on a bank loan, then the bottom-line will be different. This makes benchmarking of operations and outcomes difficult unless an EBITDA-type measure is used.

However, the system of accommodation bonds in residential aged care is unique. No other sector has these bonds. And if you receive more bonds, then you may receive fewer accommodation charges, supplements or fees. Therefore, we may need a different approach. One suggestion is to append the full details of each service's bond-holdings to its EBITDA measure. This removes the need to create an artificial 'rent' or other return on these bond-holdings.

WHAT DO WE USE?

A key requirement of any survey series is that it uses a consistent methodology to allow for year-to-year comparisons. For the past 13 years in our surveys, we have left the basis of determining income unchanged. We've always shown interest received on bonds as income and we have always sought and included the following data: the number of bonds per service; the total amount held in bonds; the average bonds received for the year; and the highest bond received for the year.

In our 2009 national survey, we will continue to include income from bonds in our EBITDA calculations. But we will give more prominence to the actual bond-holdings in each service when making comparisons, as bonds are such a key issue in our sector. ■

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