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Healthcare Linen Rental Industry
Attractive Industry Dynamics and Capital Flows Spark Increased M&A Activity

The healthcare linen rental industry is attractive to private equity and strategic buyers. A recent flurry of M&A activity indicates continued inflows of capital to the sector and acquisition activity. The industry is fragmented, companies have predictable recurring cash flows at 10%-15% EBITDA margins and opportunities exist for margin enhancements in consolidation (or privatization) transactions.

The healthcare linen rental industry is estimated at $3 billion in annual revenue and includes the laundering of bed linens, towels, patient gowns, scrubs, medical apparel, reusable operating room linens and disposable linens that are used by hospitals, long term care facilities, clinics and surgical centers. According to the American Reusable Textile Association, 2% to 3% of a hospital's budget is spent on laundry and linen services. Healthcare linen can be rented, owned, self-laundered or outsourced. An estimated 80% of hospitals and other large institutional linen users rent linen, while the other 20% own it, of which 8% of the total launder in-house.

HEALTHCARE LINEN AND LAUNDRY SERVICE OPTIONS

RENTAL SERVICE	• Hospital contracts with outside entity to provide linen services • Hospital does not own the linens • Linens are co-mingled with other linen service clients
COOPERATIVE	• Hospitals have ownership of both facilities and inventory • Hospital employees of members sit on the board of directors of the co-op • Usually structured as not-for-profits • Facilities are sometimes managed by third parties
ON-PREMISE LAUNDRY (OPL)	• Laundry facility is located on the hospital grounds and sometimes managed by a third party • Linen owned by the hospital • Laundry services may be provided to nearby clinics
CUSTOMER OWNED GOODS SERVICE (COGS)	• Hospital contracts with independent operator to wash the hospital's linens • Priced on a per pound basis and/or by the piece • Linen loss is frequent and a point of contention

The trend to outsourcing linen ownership, laundering and management has increased over the last twenty years as hospitals strive to control costs and avoid the large capital expenditures associated with laundry equipment. As hospitals seek to increase profitability, they often identify the physical laundry space for use for revenue producing services. Additionally, hospitals recognize that processing linen is not a core competency. According to *Modern Healthcare* magazine, laundry services are now the number one most outsourced service in healthcare facilities. Concurrent with the trend toward outsourcing, the growth of clinics and surgical centers has increased the need for outsourced linen services, as those entities cannot process their own linens efficiently, cost-effectively or to necessary standards.

The healthcare linen industry is metric driven. As Bob Corfield, president and CEO of Laundry Design Group stated to *American Laundry News* in October 2015:

> *"We count production. We count productivity. We count rewash. We count stains. We count tears, the bags...those are all areas that you count that you can benchmark and produce more productive workspaces."*

The key metric for plant efficiency measured is pounds per operator hour (PPOH). This metric is higher for simple linen processing (*e.g.*, sheets, towels, gowns) and lower for specialty items (*e.g.*, pediatric, specialty gowns). Plants that process COGS will have lower PPOH than dedicated rental plants due to the smaller batches.

In analyzing the financials and operating metrics of a linen rental facility, revenues and fixed and variable expenses are typically evaluated on a per pound basis. A typical linen rental facility without COGS will likely have revenues between $0.45-$0.65 per pound.

Linen Rental Companies

The majority of linens used by hospitals, clinics and surgical centers are rented. The rental company delivers clean linen to and picks up soiled from healthcare facilities as frequently as several times a day. When processing the laundry, the rental company comingles the linens - a bed sheet used at hospital A on Monday can be found at competing hospital B 30 miles away on Friday, for instance. Consequently, healthcare linen tends to be white. The linens are purchased from manufacturers such as Medline Industries and United Textile. Rental contracts are typically structured with three-year terms and increases for CPI. Customers are charged either on a per pound basis, by the piece basis or a combination of the two.

The table below lists some of the major healthcare linen rental companies.

Select Healthcare Linen Rental Companies	Description	Est. Annual Pounds *(mm)*	Number of Health-care Facilities
Alsco Inc.	Over 80 plants providing linen, industrial uniform and healthcare processing. Healthcare offered through the HealthAssure brand.	NA	NA
Angelica Corporation	Clients are hospitals, clinics and long-term care facilities. Serves 4,500 facilities nationally. Owned by Trilantic Capital Partners.	NA	25
Crothall Healthcare	Provides not only healthcare laundry and linen services, but also environmental, patient transport, technology ambulatory services and facilities management. Leader in managing laundry facilities for hospitals and cooperatives serving over 550 laundry accounts nationwide in managed facilities and its own. Owned by Compass Group PLC.	630 *including managed facilities*	55 *including managed facilities*
Ecotex Healthcare Linen Service Corp.	Clients are hospitals and medical facilities in the western US and Canada (Washington State, Oregon, New Mexico, Texas, OK, British Columbia). 500 employees. Family-owned.	150+	7
Faultless Healthcare Linen	Products and services under Faultless, Hamilton Linen & Uniform and Peerless Medical Laundry. Clients are in Colorado, Kansas, Missouri and Illinois. 525 employees. Fifth generation family-owned.	100+	4

Select Healthcare Linen Rental Companies	Description	Est. Annual Pounds *(mm)*	Number of Health-care Facilities
FDR Services Corp.	Clients are academic medical centers, hospitals, outpatient facilities and long term care facilities. Provides rental and COGS processing. Focuses on mid-Atlantic region with processing facilities in New York, New Jersey and Virginia.	75+	3
Logan's Linens/Superior Health Linens	Provides healthcare linen services for hospitals, clinics and nursing homes. Operates in Wisconsin, Illinois, Kentucky, Tennessee, Indiana and Ohio. Owned by Thompson Street Capital Partners.	100+	8
Mission Linen Supply	Provides linen and uniform rental to the healthcare, hospitality and industrial markets in California, Arizona, Texas, Oregon and New Mexico. 3,000 employees, over 800 vehicles and 43 facilities. Family owned.	200+	8
Paris Companies	Provides linen and uniform rental to the healthcare and industrial markets in Pennsylvania, New York, Ohio and West Virginia. 600 employees. Family owned and managed.	50+	3
Unitex Textile Rental Services	Full range of clients in healthcare industry from acute care facilities to walk-in medical clinics in Connecticut, New Jersey and New York. Family owned.	300+	13

Rental companies may provide an array of additional services and products, including:

- Processing customer owned linen (COGS)
- On-site linen management and distribution
- Software to manage linen
- Mop and mat rental (aka dust control)
- Scrub dispensing systems
- Uniform embroidery
- Lab coat and uniform rental
- Disposable linens for surgical uses
- Instrument sterilization
- Disposable supply delivery and/or distribution

There are over 150 healthcare linen rental companies in the U.S. utilizing various business strategies. Some companies, such as Ecotex and Angelica, only process healthcare linens. Others, such as Alsco and Mission, process healthcare, commercial and hospitality linens. Companies such as Crothall Healthcare (subsidiary of Compass Group), Sodexo and Unitex not only own laundries but also manage on-premise laundries for hospital systems and free-standing laundries for cooperatives.

Cooperatives

There are an estimated 100 cooperative laundries around the U.S. owned by healthcare systems or groups of hospitals. The cooperatives are structured as non-profits and are typically managed by a board representing the member hospitals. Co-ops own their linen, equipment and sometimes the facilities. Third parties such as Sodexo, Crothall and ARAMARK manage approximately 40% of these plants on behalf of the co-op boards.

The table below lists some of the major cooperative healthcare laundries.

Select Cooperative Healthcare Laundries	Est. Annual Pounds *(mm)*	Location	Select Members
Comtex Laundry	42	Columbus, OH	Mount Carmel and OhioHealth Systems
Hospital Central Services (HCSC)	90	Allentown, PA	Grand View Health, Blue Mountain Health System, Penn State University
Hospital Cooperative Laundry	50	Denver, CO	St. Anthony Hospitals, Swedish Medical Center and Rose Medical Center
Madison United Healthcare Linen, Ltd.	20	Madison, WI	University of Wisconsin (44%)
Michiana Linen	5	Elkhart, IN	Beacon Health System
Michigan Premier Laundry	15	Saginaw, MI	St. Mary's of Michigan, HealthSource of Saginaw, Covenant Health System, Tawas St. Joseph Hospital, and McLaren Bay Region
Shared Hospital Services Corporation	NA	Nashville, TN	Vanderbilt University Medical Center, Saint Thomas West, Saint Thomas Midtown and Williamson Medical Center
United Hospital Services, LLC	38	Indianapolis, IN	Owned by 11 hospitals including Clarian Health, St. Vincent Health, Community Health Network and St. Francis
Virginia Hospital Laundry	10-12	Richmond, VA	VCU Health Systems, Centra Health
West Michigan Shared Hospital Laundry	33	Grand Rapid, MI	Metro Health Hospital, St. Joseph Regional Medical Center, St. Mary's Healthcare

On-Premise Laundries

Some hospitals choose to use OPLs and own their linen. This structure can be advantageous for some hospitals as it enables them to directly monitor quality and amount of linen stock. Some OPLs use third-party contract management companies such as Sodexho, ARAMARK, Crothall and Unitex to operate their facilities.

Investment Case for the Linen Rental Industry

Predictable, recurring cash flows

Healthcare linen processing companies generally enter into three-year contracts with hospitals and clinics resulting in predictable cash flows with annual increases for inflation. A well-run company should maintain EBITDA margins of 10-15%.

Opportunities to acquire cooperatives and OPLs at attractive valuations

Cooperative and on-premise laundries present attractive acquisition targets. As non-profit entities and captives serving their owners, these laundries may not be running at peak efficiency. For example, Healthcare Laundry Systems was a cooperative sold to Blue Wolf Capital Partners; and during the private equity firm's ownership, margins were enhanced through better inventory management, stronger contracts with enforcement of terms, improved production monitoring, redesigned plant layout, capital investments and improved relations with the unions. (Blue Wolf successfully exited this investment at a substantial gain.)

Cooperative laundries may sell for a few reasons. Laundry is generally not a core competency for hospitals; and recognizing this can be a motivator for selling. The need for on-going capital investment, or the failure to do so, sometimes precipitates a sale. Additionally, considerations around the non-profit tax status can stimulate a sale process. To efficiently use capacity, cooperatives sometimes process linen for for-profit clinics and surgical centers. There are limits to the revenues non-profits can have from for-profit entities before triggering risks for the non-profit status. Finally, hospitals are generally eager to redeploy the capital from a sale transaction to other strategic initiatives.

Fragmented market; considerable add-on acquisition opportunities

Acquiring regional competitors can be attractive on several levels. Local acquisitions can not only drive obvious synergies, but can also remove a competitor from the marketplace and therefore lessen pricing pressure on contracts. Scale enhances margins by increasing PPOH at plants and improves purchasing power. Strategically acquiring plants can position a linen rental company to win contracts with a health system with locations in multiple geographies. The acquisition of a facility in an adjacent geographic area provides the opportunity for the buyer to centralize laundry processing and use the other facility (or close it and acquire a smaller space) as a depot from which it distributes thereby increasing the plant's footprint.

Opportunity for margin and cash flow improvements

Plants that have been under-managed and under-invested in represent opportunities for improvements. Areas for investigation include:

- Additional revenue streams such as on-site linen management, software, exchange carts, and new product lines
- Inventory management
- Accounts receivables collections
- Plant workflow design
- Utility costs (hedging/long term contracts)
- Equipment maintenance
- Investment in equipment to increase efficiency
- Investment in depots to expand geographic reach
- Production monitoring and measurement
- Owned land that can be monetized through a sale-leaseback

Investment Considerations

EBITDA and Linen Depreciation

The purchase of linen is typically the largest cash expense for healthcare laundries. In GAAP accounting for healthcare linen rental companies, the linen costs are amortized over the expected useful life of the linen. When valuing a linen rental company, EBITDA should include the linen depreciation expense, as the linen is a core operating expense. It is important to analyze the depreciation schedules for the linen, as not all companies handle depreciation uniformly. The useful life of the linen will be impacted by product quality, usage, chemical formulation, processing practices and equipment maintenance.

Linen rental companies must also account for linen losses. According to the TRSA (the commercial textile services organization), nearly 90% of all linen used in U.S. hospitals does not reach its useful life, costing the healthcare industry over $840 million annually. According to the Healthcare Laundry Accreditation Council (HLAC), only 25% of linen replacement cost is due to linen reaching the end of its useful life while 75% is due to theft, ambulance transfers from hospitals to nursing homes, unexplained loss (discarded in trash) or misuse. You have likely seen the ubiquitous white with blue and thin red stripe blanket that swaddles newborns in their first photographs. That baby blanket is likely owned by the linen rental company and falls into the "misuse" category once it is taken home by the new parents. Linen rental companies must either account for linen losses in calculating the useful life of the linen or as a regular write-off.

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Impact of Minimum Wage Increases

Salary and wages is the second largest category of expenses for a healthcare linen rental company. Laundry workers are paid an average of $10.61 per hour, according to the Bureau of Labor Statistics (May 2015). Increasing the minimum wage, as being considered by many jurisdictions, will increase the payroll line at many healthcare laundries. The impact can be mitigated contractually with pricing escalator clauses in the contracts with customers.

Margin Compression

In some regions, healthcare linen rental companies have experienced margin compression due to hospital consolidation and hospital expense rationalization. Many hospital linen contracts contain a clause that allows the hospital to exit its linen/laundry contracts upon being acquired or a merger. Hospitals view such events as an opportunity to renegotiate their linen contracts. Hospital systems also look at laundry expenses as low hanging fruit in budget reviews and continually keep pressure on prices.

Competition is dampening margins in some geographies. Larger entities, such as Crothall and ARAMARK, provide other services to hospitals such as environmental services, food and patient transportation, and are able to absorb lower linen margins when the contract is balanced against total services provided to a hospital. It can be challenging for an independent, mono-line laundry to compete.

Capital Expenditures

Industrial laundries are capital intensive, and ongoing investment in maintenance of the machinery is significant. Access to capital, scale and utilization rates are important.

M&A Activity in the Healthcare Linen Industry

M&A activity in the healthcare linen industry has been increasing, as strategic buyers and private equity backed companies are flush with capital and are in the process of executing consolidation strategies.

The table on the next page lists significant recent transactions in the healthcare linen industry.

Date	Target	Acquirer	Comments
Oct-16	Superior Health Linens	Logan's Linens (Thompson Street Capital Partners)	Provides healthcare linens services for hospitals, clinics and nursing homes in the upper Midwest with six plants in IL and WI. Processes over 50mm pounds annually. Acquired from PS Capital.
Sep-16	Booth Centennial Healthcare Linen Services	Fengate Capital Management and Ecotex	Jointly acquired by Fengate and Ecotex. Provides linen, laundry and surgical sterilization services to hospitals and long-term care facilities at over 100 sites in Ontario (40% market share). Processes 78mm pounds annually in its single facility. Sold by a cooperative of 22 hospitals.
Jul-16	Oceanside Institutional Industries LLC	Unitex Textile Rental Services	One of the largest healthcare linen rental, laundry and uniform rental providers on the East Coast (Oceanside, NY). Customers include 6 NYC hospitals, 14 nursing homes and 50 outpatient healthcare accounts. 150 employees and 40mm pounds. Family owned.
Sep-15	Amertex Textiles Services' Healthcare Uniform & Textile Business Division	Unitex Textile Rental Services	A healthcare linen and uniform rental service with 600 accounts based in the New York and New Jersey area. Family owned.
Apr-15	Admiral Linen and Uniform Service	Alsco Inc.	Four plants in Texas in Houston, Fort Worth, Wichita Falls and Corpus Christi focused on linen, industrial uniform and healthcare processing. Privately owned.
Feb-14	Judges	Superior Health Linens	Provides healthcare linen in north and central Wisconsin. 55 employees. Privately owned and operated.
Oct-11	Linen King	**Clairvest Equity Partners**	Oklahoma-based healthcare and hospitality services rental company. Privately owned and operated.
Mar-11	**Healthcare Laundry Systems**	Crothall Healthcare	The largest single site healthcare laundry in the U.S. at the time of sale processing over 70mm pounds annually serving hospitals, clinics and surgical centers in the greater Chicago area. 500 employees. Sold by Blue Wolf Capital Partners.

Note: Bold denotes transactions on which Colonnade principals have worked.

Conclusion

The healthcare linen industry will continue to see strong M&A activity as buyers capitalize on opportunities to acquire companies with highly predictable, recurring cash flows and margins with room for enhancement. Several private equity firms are executing roll up strategies in select geographies; and strategic buyers, flush with capital, continue to buy smaller local and competitors to improve scale and efficiencies. We expect significant M&A activity in the next 24-36 months as investor interest in this sector expands.

Colonnade has Unique Experience in the Healthcare Linen Rental Industry

Gina Cocking, Managing Director of Colonnade, was previously the Chief Financial Officer and Director of Human Resources at **Healthcare Laundry Systems** (**HLS**) under the ownership of Blue Wolf Capital and was instrumental in the successful execution of the sale of the company to Crothall Services Group. During Blue Wolf's ownership, the company's revenue increased by 50% through a combination of organic growth and acquisitions. The company improved productivity and its safety record, even while increasing its employee base by nearly 25% to support volume growth.

Colonnade advised Clairvest Group Inc. (TSX: CVG), a Toronto-based private equity management firm, on its growth equity investment in Linen King LLC, an Oklahoma-based textile rental services company that provides commercial laundry services to the healthcare and hospitality industries.

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