Top 10 Considerations When Contemplating the Sale of a Home Health Agency or Hospice

By Dexter W. Braff

With substantial financial equity (not to mention the emotional and sweat variety) tied up in a home health agency or hospice, for most owners and entrepreneurs, the sale of their company is likely to be the single most important business decision they will ever make. Therefore, this decision requires careful planning and analysis. Here then are the top 10 items to consider if you are contemplating the sale of a home health agency or hospice.

The first five items deal with timing a transaction – arguably the most critical foundation of a divestiture strategy.

Position on the Growth Curve. Buyers value growth up to a point. While it may seem that from a valuation perspective, the faster the growth, the better, buyers frequently underestimate projections of firms in "hyper-growth" (compound annual growth rates of 30 percent or greater) because such growth is rightly seen as unsustainable over the long term. Consequently, they tend to under-predict go-forward results over the short term as well, results which are often quite achievable. As such, firms at this stage of the growth curve rarely receive the full measure of the growth premium due them. On the other hand, buyers generally ascribe little premium value to "market growth" – growth of 0 to15 percent – which is essentially keeping pace with the organic expansion of the market. The best position to be in on the growth curve in order to realize the maximum "growth premium" consistent with the firm's near term prospects, is when the firm is in the midst of "mature growth" – growth of 15 percent to 30 percent annually.

Merger and Acquisition (M&A) Market Dynamics. For a variety of reasons including reimbursement, changing operating strategies, and the relationship between the supply of and demand for acquisition candidates, the M&A market climate for various sectors changes over time. Clearly, all other items being equal, sellers are best served testing the M&A market when their individual sector is "hot". While a comprehensive review of the market dynamics of the various sectors within home health and hospice is beyond the scope of this article, it should be noted that the climate for Medicare certified home health is, by far, not only the most vibrant we have seen since the mid-90s, but is also likely at or approaching its peak.

Personal Goals and Objectives. When contemplating the timing of a divestiture strategy, personal goals and objectives often outweigh the growth cycle and market dynamic considerations described above. Therefore, they can and should play a crucial role in the planning process. Paramount among these personal issues is passion versus burnout. This is especially the case in home care and hospice, where the initial motivation for many owners to get into the business is driven more by the desire to help others, than to reap financial gain; some find greater "value" in retaining their business rather than selling. For others, with the memories of BBA '97 market meltdown still fresh, the promise of financial security is simply too great to take on the risk of not divesting. And for others still, burnout (or boredom) becomes the catalyst for divesting to pursue other business and/or personal opportunities, including retirement.

Unsolicited Queries. While certainly flattering, owners should take great care in responding to a buyer's unsolicited overture to acquire his or her firm. Faster than you can ask "what do I have to lose?", owners often get drawn into a one-on-one sale process absent the marketing leverage and control that comes from identifying, presenting, and negotiating with a broad spectrum of qualified buyers; an approach that, in turn, is so critical to maximizing value in all its forms – dollars, clinical and cultural fit, employee security, etc. Best to say "thanks, but no thanks", and go to market on your terms, on your time schedule, and with the same kind of proactive planning and strategic thinking deployed in starting the business in the first place.

Valuation. Conceptually, the decision to sell or hold a business can be distilled to the following question: "Are my future opportunities, financial and non-financial, substantial enough to compensate me for the risk of not selling today?" While the future component of the equation can be evaluated, in part, by assessing growth opportunities, expected M&A market dynamics, and personal goals and objectives, the other side of the equation (the risk or opportunity cost of not selling today) is based primarily upon valuation. This mental calculus should be an ongoing process. As such, owners should continually monitor the range of value for their companies, and the probabilities of achieving such values in a strategically developed divestiture process.

Corporate Status. Given the potential of assuming unknown liabilities in transactions structured as a purchase of stock, buyers typically acquire assets instead. This can be problematic for C corporations, as this frequently results in “double taxation”, first at the corporate level, then at the shareholder level. With taxes a critical consideration in determining a divestiture strategy, though owners should always consult with their tax counsel, it is often wise for C corporations to switch to S corporation status. Note that this takes substantial advanced planning since significant benefits can be frequently gained over the near term; any built-in gains that existed at the time of the conversion remain taxable at the corporate level for 10 years.

Compliance. Terminated transactions, or those subject to price reductions, can be extremely disruptive, time consuming, emotionally taxing, and costly in terms of resources spent and purchase price lost. And deals often derail as a result of compliance issues that can often be easily uncovered before a company goes to market and dealt with before they undermine a transaction. As such, owners contemplating a sale should strongly consider having an outside consultant conduct a pre-market mock due diligence.

Financial Reporting. Of all the sectors we cover (Medicare and non-Medicare home health, hospice, staffing, home medical equipment, infusion therapy, and specialty pharmacy), Medicare home health, with complexities regarding PPS revenue recognition, and hospice, with exposure to exceeding annual cost caps, can be the trickiest to accurately report financial performance. With valuations being driven in large part by financial performance, the cost of going to market with the wrong numbers can be substantial; both in terms of lost valuation or an ill-advised, ill-timed transaction (see valuation above). Consequently, getting one’s financial reporting in order consistent with industry practice is critical for anyone contemplating a divestiture strategy.

Retention Bonus Plans. In service intensive industries such as home care and hospice, value is often directly a function of the quality of the firm’s people. From a buyer’s perspective, expected retention or loss of key employees is a key element in a firm’s risk profile. To mitigate this risk and increase value, companies are well served to consider and develop retention bonus plans in advance of a divestiture strategy. While these plans can be put into effect post transaction, they can also be put in place long before a divestiture strategy is executed. For example, immediately prior to closing a deal, one or more key employees can be offered a bonus payable one year after the close should they remain with the buyer during that time. Consider, for example, a plan where high level management and key sales people that have a direct impact on a firm’s growth and profitability, receive bonuses based on increasing value, with half paid at close, and the balance paid one year later should these key employees remain with the firm. Though somewhat complex, when crafted well, such plans not only increase retention, but also provide key staff with strong incentives to help create intrinsic value.

Advisors. If your initial reaction to this final item is that it is merely self-serving, the reality is that experienced counsel can play an extremely vital role in providing critical insight on many of the issues described above, particularly those dealing with market timing and valuation. Since these issues and others critical to the success of a divestiture strategy can and should be considered as part of an ongoing strategic planning process, owners are often well served by beginning a dialogue with M&A advisors long before reaching a decision to sell.

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