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Expect continued home health consolidation in the face of Medicare payment cuts

Pending Medicare payment cuts will force small, proprietary home health agencies to close their doors in 2011, causing an uptick in mergers-and-acquisitions activity.

Next year will be “a banner year” for home health mergers as the continued pinch on Medicare home health profits will force sales of weaker agencies, says Beau Sorensen, director of finance and operations, First Choice Home Health and Hospice, Orem, Utah.

Small, rural agencies will get hit the hardest by the continued payment cuts, including the average 4.89% cut to episode payments in 2011, fears Judy Adams, president and CEO, Adams Home Care Consulting, Chapel Hill, N.C. (*HHL 11/8/10*).

That’s because rural agencies are challenged to find adequate staff, including qualified therapists to provide high-dollar services, Adams says. At the same time, those agencies bear the added costs of traveling longer distances to visit patient homes.

The loss of those agencies will result in less availability of home health services to the most vulnerable population, including less profitable Medicaid and daily care patients, Adams expects.

Smaller agencies also lack the infrastructure necessary to handle the increased compliance burdens, says Barbara McCann, chief industry officer, Interim HealthCare, Sunrise, Fla. They often lack the knowledge and strategic leadership skills needed to keep the business going while positioning themselves for the changing care-delivery landscape, she adds.

As a result, there will be an increase in regional players or smaller agencies “woven” together to cover a larger geographic area, McCann predicts. Those agencies will benefit from lower direct costs associated with back-office support, and they’ll be better positioned for managing the larger geographic area that accountable care organizations (ACOs) will be responsible for, McCann says.

HH transactions were down in 2010

The most significant development that could favorably impact Medicare home health mergers-and-acquisitions activity in 2011 would be a quick and painless resolution of the investigations against the “Big Four” publicly traded home health companies, says Dexter Braff, president, The Braff Group in Pittsburgh (*HHL 5/17/10*).

Even if fines are levied on one or more of the companies, the substantial “risk overhang” – which has driven median public valuations to their lowest levels in at least five years – will finally lift, Braff says.

As the risk fades, buyers may be drawn to the attractive and sustainable revenue, growth and profit fundamentals that characterize the Medicare home health sector, Braff says.

The number of Medicare home health transactions was down 21% to 48 transactions through the end of the third quarter 2010, compared with 61 deals for the same period in 2009, according to data from The Braff Group.

In addition to the investigations of the “Big Four,” there are a few other reasons why the Medicare segment has fallen this year after record-setting activity in 2008 and 2009, explains Braff:

- Scheduled price cuts stemming from health care reform
- Continued case-mix creep adjustments
- Pre- and post-transaction complications arising from the 36-month rule.

The “Big Four” will continue to seek acquisition activity in 2011. The difference is that buyers’ clinical, regulatory and financial standards will be raised to new levels, Braff says. For buyers and for lenders that finance deals, the M&A “watchword” will be compliance, Braff says.

The strong will diversify their services

While Medicare home health activity is down, private duty activity is up 11%, with 20 transactions through the third quarter 2010 versus 18 during the same period in 2009, data from The Braff Group show.

The increased acquisition demand for private-duty providers is a direct response to increased wariness regarding Medicare, Braff says.

And The Braff Group expects even greater private duty M&A activity when the economy begins to show signs of meaningful and sustainable recovery.

Those agencies that will be best positioned for the pending Medicare home health payment cuts will be those that offer a broad spectrum of pre- and post-acute care services, says Jeannee Parker Martin, president and co-owner, The Corridor Group, Overland Park, Kan. They'll be more desirable to patients because they serve as a one-stop shop.

Martin also expects the payer mix to change to a lower percentage of Medicare and higher percentage of managed care and other payers as agencies work to diversify, she says.

Diversification is critical, McCann agrees. But agencies must acknowledge that the infrastructure and delivery processes are different. The intake, sales process and staffing of acute episodic care versus long-term private pay is different, McCann says. Without planning for those differences, both can be adversely affected.

The demographics must be carefully considered before making large investments in alternative programs, adds Lynda Laff, Laff Associates, Hilton Head Island, S.C. Private pay models only work when the targeted population has the ability and the desire to privately pay, Laff says.
– Marci Heydt (mheydt@decisionhealth.com)

Hospice acquisitions remain at the top of buyers' wish lists for 2011

The hottest mergers-and-acquisition segment, at least in the beginning of 2011, will continue to be hospice, says Dexter Braff, president, The Braff Group in Pittsburgh. That's due to the comparatively benign reimbursement climate and prospects for stable payment methodology through the end of 2012.

Hospice M&A activity was up 18% with 20 deals through the third quarter of 2010 versus 17 during the same period last year, according to The Braff Group.

Hospice is "where we continue to see record deal volume and peak valuations," Braff says. But much like the valuation periods in the stock market, housing, technology and Medicare home health in 2007 and 2008, the current hospice phenomenon is indeed a "bubble" that will not last, Braff says.

Hospice M&A pricing will inevitably fall as the industry gets closer to payment-system changes and buyers begin to factor those and other unknowns into their valuations, Braff says.

But for now, hospice is on top of buyers' wish lists, from hospice consolidators to Medicare home health providers to long-term care providers and private equity. So in M&A where timing is everything, the timing is now. – Marci Heydt (mheydt@decisionhealth.com)

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