



Home Health Line

Regulatory news, benchmarks, best practices & executive tools for home care profitability & growth

**March 17, 2008
Volume 33, Issue 11**

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HHAs for sale, but buyers often don't like what they find

Despite PPS uncertainties, the appetite of growth-minded home health companies and their financial backers for HHA purchases remains sharp, especially in locales with large concentrations of retirees.

But many agency owners hoping to cash in on the strong demand may not find the pot of gold they're looking for. In fact, too many agencies with characteristics deemed bad by prospective buyers are fated for below-market bids – or no bids at all – warn executives of companies that are in the market for home health acquisitions and the merger and acquisition consultants who are providing them leads.

“Reasonable length of stay,” for example, is one of the things Encompass Home Health is on the lookout for as it seeks to increase its 47 locations in Texas, Oklahoma and New Mexico, says CEO April Anthony. “If increased recerts are propping up an agency’s census, it’s problematic, because it means we’re buying the past, not the future,” Anthony observes. Unlike new admissions, patients who’ve received three or more episodes of care eventually are going to leave home care for care provided by family members or a nursing home, or because they’ve died, she says. *[For more qualities Encompass wants – and doesn’t want – in a prospective home health acquisition, see p. 3.]*

2008 acquisitions market: Off and running

Judging by a trio of major home health purchase announcements last month, 2008 is off to a “roaring start,” in the eyes of mergers and acquisition adviser Dexter Braff.

Amedisys agreed to buy 92-agency Tender Loving Care for \$395 million; Gentiva Health Services completed its \$55 million acquisition of Home Health Care Affiliates, a company that operates through 14 Mississippi locations under the names of Gilbert’s Home Health and Gibert’s Hospice Care; and MBF Healthcare Acquisition Co., a Coral Gables, Fla., company organized just under a year ago to buy health care properties, agreed to pay \$420 million for home infusion provider Critical Homecare Solutions.

The record number of 2007 home health mergers and acquisitions compiled by Braff’s firm, The Braff Group in Pittsburgh, is another indicator of the trend. It counts 107 home health deals overall in 2007, up nearly 14% from the 94 in 2006. Even with the PPS uncertainties and CMS’s case-mix reduction, home health valuations in 2007 “ticked upwards, particularly for the most sizable, Medicare-focused”

HHA's, Braff says.

Luis Gonzalez, a member of the team that engineered the MBF Acquisition Corp. purchase of Critical Homecare Solutions, is no less sanguine about HHA values, to the point that the MBF private equity affiliate he heads currently is negotiating to buy a 25,000-episode agency located in a southeastern state. What he sees in favor of such acquisitions is an industry whose 7% annual growth rate -- 8% for Medicare payments alone -- will propel its current \$55 billion in overall yearly revenues to \$96 billion by 2014, he says.

Favorable factors noted by Gonzalez include the growing number of seniors and the demand for home care as an alternative to institutional care. Furthermore, the "highly fragmented" home health market -- which now has 9,200 Medicare-certified agencies competing for referrals, the Medicare Payment Advisory

Commission reports -- offers investors an opportunity to pursue a "roll-up" consolidation strategy in some markets by buying "mom-and-pop" agencies that typically may have only \$300,000 to \$500,000 in annual revenues, Gonzalez says.

Case history of a low offer the HHA refused

But an agency up for sale can find itself swept off the negotiating table if the potential buyer senses referral and management negatives, cautions Regina McNamara, president of Kelsco Consulting Group in Cheshire, Conn. She offers the following composite example -- based on three actual cases -- of a Midwestern HHA that interested a potential buyer, her client.

The could-be purchaser already owned a large private duty agency in the HHA's service area and saw the purchase as an alternative to starting his own

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Home Health Line (ISSN 1078-2389) is published weekly (except for Memorial Day, Labor Day, Thanksgiving and Christmas) by DecisionHealth, 11300 Rockville Pike, Suite 1100, Rockville, MD 20852-3030. Postmaster send address changes to Home Health Line, 11300 Rockville Pike #1100, Rockville, MD 20852-3030. Price: \$467/year. Copyright 2006. DecisionHealth is a registered trademark of UCG.



agency from scratch. What he saw initially was an 8-year-old HHA that had grown from nothing to an 80-patient census and a 90% Medicare payer mix, based on visits. He was impressed by the HHA's 15% profit

margin and the fact that over 60% of its cases required therapy, largely due to the two owners' close connection with a local therapy company that provides both therapists and referrals.

7 things a major player looks for when purchasing an HHA

As CEO of Encompass Home Health, April Anthony stands out in the current market for HHAs as an avid buyer. Since 2004, with the backing of Chicago-based Toma-Cressey Equity Partners, which holds an 80% interest in Encompass, her company has purchased 12 home health companies on its way to the 47 locations it now has in Texas, Oklahoma and New Mexico.

But to get those 12, Encompass had to analyze 50 possible transactions. So a look at Anthony's checklist for judging good and not-so-good buys may be instructive for agency owners with a yen to sell. In addition to avoiding agencies with too many long-stay patients [*see story, p. 1*], they include:

✓ **Diverse referral base** – Encompass is always concerned about risk concentration. The agency doesn't like to see more than 10% of the total referrals coming from a single source. If it is a large percentage then it would feel like there are multiple relationships supporting that account. For example, if it is a large hospital referral source then we would want to be confident that there are a variety of discharge planners that are producing the actual referrals.

✓ **Patient mix** – Inherent risks or opportunities with the types of patients the agency sees most often. For example, consider whether the agency has a large percentage of wound-care patients that might become more or less costly due to the recent changes in reimbursement. Or perhaps the agency has a large percentage of high-visit-volume therapy patients, who could represent an opportunity.

✓ **A lone marketer** – If an HHA candidate for purchase has just one sales person, it raises concerns. While Encompass believes it can keep staff happy after the HHA candidate is acquired, "we're aware that acquisitions are a time for people to reconsider their futures," Anthony says. At a \$6 million HHA Encompass turned down, the single marketer, who was doing 70 Medicare admissions a month, had a 15% ownership share -- "enough for her to stop working," Anthony notes. Encompass often seeks to mitigate the risk of losing such "key revenue drivers" by entering into retention agreement(s) with them, she adds.

✓ **Staff stability** – Low turnover is an important indicator of the staff's commitment. "Even if staff loves the current owners, I want to work with people who are committed to the organization and liked by their co-workers," Anthony says. "A 35% annual turnover for an agency with 100 employees probably is too high. If you're going to lose that many people, you might as well buy a little agency or start one from scratch."

✓ **The candidate HHA's culture** – "Ultimately, this is the most important factor in understanding how the organization will respond to our post-acquisition integration plans," Anthony says. Questions to answer include: Do they currently use technology? Do they have productivity goals and, more important, are the goals monitored and does the staff achieve them? How process-oriented is the organization, or is everything a fly-by-the-seat-of-the-pants decision?

✓ **How their performance benchmarks against yours** – If it is higher than performances by Encompass, why, and can Encompass sustain the approach? One of the ways they have maintained high margins, for example, may be by not carrying workers compensation insurance. "This is not a risk we're willing to assume. We'd have to adjust their numbers to show the impact of our standard insurance coverage approach," Anthony says.

If a prospective buyer has high back-office support costs, Anthony knows that she and her staff can bring them down. But that could backfire if it's going to result in a large number of layoffs, creating instability across the organization.

Another pitfall is clinician productivity. Most administrators set five to six nurse visits per day as their standard. But while Encompass is strict about its daily average of 5.2 visits, an agency it's considering may be allowing nurses to do only four or five visits in order to accommodate their family schedules. If the purchase goes through, that could mean nurses dissatisfied with "doing more work for the same salary," Anthony notes. "I am always leery of situations where I am being asked to pay the seller for something I am going to have to do post-closing," she says. – *Burt Schorr [bschorr@decisionhealth.com]*

Even though the agency's two owners intended to have no role in its operations after the purchase, they were fairly certain that their management team members would remain on the job after they were gone. Given the positives, they had decided on a sale price equal to their agency's \$2 million in annual gross revenues.

But a due-diligence check by consultant McNamara provided the buyer with a different perspective:

⇒ **Higher health care premiums were on the horizon for the agency.** Because benefits were important to staff retention, higher health coverage costs could affect retention in the future.

⇒ **That 80-patient census wasn't what it appeared to be.** An accurate monthly census of active patients showed the total actually was only 70, not 80. And while 90% of the agency's visits were Medicare visits, standard fee-for-service Medicare accounted for only 70% of admissions, reflecting a steady, three-year decline due to a rising Medicare Advantage penetration in its service area.

⇒ **The agency had significant growth during its first four years, but little to flat growth since then.** There were reasons to believe that picture wouldn't change, including the fact that its revenue per Medicare admission was steadily declining, and overhead was steadily increasing, McNamara found. Also, the agency never had a sales strategy, but depended on the two owners' personal relationships with referral sources. The big unknown: Would referral source loyalty carry over to the new owner?

⇒ **Salaries and other overhead were above average and utilization wasn't monitored.** Improved growth and profitably would require a complete overhaul of the agency's operations, McNamara advised her client.

⇒ **Bottom Line:** "The buyer offered a price much lower than the asking price. The seller refused. The buyer walked," McNamara says. -- *Burt Schorr*
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