The Top 10 Attributes of Ideal Home Health and Hospice Acquisition Candidates

By Dexter W. Braff

You’re a buyer. Whether it is the addition of new product lines, new payer sources, access to contracts, increased market penetration, expansion of geographic coverage, leveraging infrastructure to increase profitability, or simply building the top and bottom lines, you have a clear and defined acquisition strategy. You’ve identified candidates that appear to meet one or more of your acquisition objectives. Now it’s time to narrow the field to a select few to whom you may wish to make an offer. While desired characteristics will certainly vary from buyer to buyer, based on our experience with literally hundreds of acquirers across hundreds of transactions, the following are the top 10 attributes of ideal acquisition candidates.

1. They are scrupulously compliant. Given the enormous exposure arising from non-compliance with federal and/or state guidelines regarding employment matters, taxes, etc., this is clearly the most critical characteristic of an ideal acquisition candidate – the absence of which will lead the majority of buyers to simply (and quickly) walk away from a potential transaction.

2. They have financial statements that accurately represent the firm’s performance. Ideal acquisition candidates do not necessarily need audited or reviewed financial statements. They don’t even have to be compiled by an accountant. But there must be evidence that they are routinely prepared in a consistent manner – preferably on an accrual basis of accounting rather than a cash basis, which can substantially distort a firm’s performance. They must have all the basics: balance sheet with breakdowns of assets, liabilities, and retained earnings; income statements detailing revenues (with adequate reserve for LUPAs, adjusted case-mix weights, missed therapy thresholds, cost caps [hospice], contractual allowances, and bad debt), cost of services, gross profit, operating expenses, operating income, and net income. Absent these, it becomes difficult to accurately analyze and identify financial and operating strengths, weaknesses, and critical post-transaction opportunities. And if any of the numbers literally don’t add up, i.e. if you can’t tie a firm’s income statement to the balance sheet through the retained earnings account, it’s a dead giveaway that something may be awry. Not necessarily fraudulent, but enough to bring into question the accuracy of the firm’s financial report card – and hence, its prospective value.

3. They have a relatively tight footprint. With margins continually under pressure, buyers are likewise continually looking for opportunities to leverage management and operating infrastructure. Accordingly, rather than looking to simply pick up “dots on a map” – with multiple facilities and infrastructure (and often excess capacity) that is both expensive and can spread management resources thin – buyers are increasingly targeting firms with greater market penetration over a relatively tight geographic area. Allow bonus points for growing markets with mid to high population densities and easy travel access.

4. They are trending upwards. A bright outlook touted by an acquisition candidate notwithstanding, nothing is more telling about a firm’s future potential than its most recent performance trends. If the trends are up, there’s a reasonably good chance that there is a sales, operating, and management infrastructure in place to support continued growth over the near term (more on this in items 5-8). If the trends are down, it begs the question whether an organization may be in the beginning stages (or midst) of a downward spiral. And although troubled firms may sell at a discount, with all the resources – financial and otherwise – that must be devoted to reversing such trends, bargain transactions can often wind up being the most expensive.
5. They have a professional sales force in place. Perhaps the greatest concern a buyer has post-transaction is erosion of revenues due to factors including the loss of a retiring owner with close ties to the community and vulnerability to competition that can occur during periods of transition (which even in the best of situations can still be difficult). The existence of a well-trained, well-incented sales force (with reasonable and enforceable non-competes) gives buyers increased confidence that what they are buying will still be there long after the check has cleared.

6. They derive revenues from diverse referral sources. Even when there is a professional sales force in place to sustain ongoing referrals post-transaction, if any one or more of an acquisition candidate’s referral sources account for a disproportionate amount of business – 10-15 percent of revenues or more – there is substantial risk that an equally substantial chunk of revenue could vanish as a result of the normal ebb and flow of referral patterns, not to mention increased sniping from competitors looking to capitalize on real (or perceived) instability during transition periods.Ideal acquisition candidates, then, boast an extremely diverse pool of referral sources with minimal to no revenue concentration.

7. The have strong middle management. Even if an owner and buyer both desire and mutually agree that it is best for the owner to remain with the firm post-transaction, it must be recognized that what makes entrepreneurs successful – independent thinking, and the desire to employ that independent thinking to take risks and make decisions without seeking outside counsel – does not necessarily make for a good corporate citizen. Accordingly, an ideal acquisition candidate has strong middle management in place to sustain and support the firm’s operations and strategies should the owner depart.

8. They have a high care-giver retention rate. A firm’s ongoing revenue opportunities are only as strong as the caregiver force in-place to support those revenues. Recruiting and training new caregivers is extremely expensive and disruptive. So firms with a high retention rate – generally arising from a management commitment to provide ongoing training, support, incentives, and a superior work environment – are highly desirable.

9. There is a strong cultural fit. In an industry so dependent on people, buyers in the home health arena are particularly tuned into the corporate culture of an acquisition candidate, and whether or not it will fit well with that of the buyer’s. While a culture clash and the transitional challenges that could arise from it may not necessarily kill a deal, for many buyers it is definitely a cause for pause.

10. They pass the gut test. Whether it’s from the appearance of a facility and its employees, the buzz (or lack thereof) that subtly permeates an organization, or what can be gleaned by looking into an owner’s eye, virtually every buyer meets with an acquisition candidate to surmise the intangibles, to gain insight into that which is better felt than read, and to ultimately determine if a firm passes the gut test. While the gut check is entirely non-financial and unsystematic, it must be remembered that corporations don’t buy companies – people do. And to individual buyers, an ideal acquisition candidate looks and feels, well…ideal.

About the Author: Dextor Bruff is President of The Bruff Group, a leading middle market merger and acquisition firm that specializes in the home health care, hospice, staffing, home medical equipment, specialty pharmacy, infusion therapy, and eHealthcare market sectors. The firm provides merger and acquisition representation, strategic planning, and valuation services. He can be reached at 888-922-5169, dbruff@thebruffgroup.com, www.thebruffgroup.com.