

The Strategy for Value Creation

Optimizing Inorganic Growth Within the Home Care Industry Through Systematic Health Care M+A

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The home care industry is continuing its consolidation trend. Home health, home care and hospice agencies (collectively “home-based care” agencies) with enterprise values less than \$10 million are increasingly pursued as attractive acquisition candidates by a variety of prospective acquirers. Over the past several years, private equity funds, large health care and home-based care providers, healthcare insurers and other payer models have completed hundreds of home-based care agency acquisitions.¹ In fact, home-based care transactions reached a national high in 2020, with a recorded deal count of over 240 and an aggregate deal value of over \$13 billion.² While opportunities to transact had previously been reserved primarily for larger home-based care agencies with multi-state footprints, large work forces and higher revenues and EBITDA, the recent proliferation of smaller-sized deals is helping contribute to acquirers’ increased earnings and market share and other benefits of inorganic growth.

HOME-BASED CARE



HOME HEALTH

HOME CARE

HOSPICE

The acquirers and sellers who are driving the overall growth and value creation through these lower middle market home-

based care acquisitions are utilizing a programmatic mergers and acquisitions strategy.³ A programmatic mergers and

¹ The value for home health care deals increased 11% in 2020 from the previous year, reaching an aggregate disclosed deal value of nearly \$2 billion. “Health services deals insights: 2021 outlook,” PWC, <https://www.pwc.com/us/en/industries/health-industries/library/health-services-quarterly-deals-insights.html>.

² This aggregate data was compiled by PitchBook, which only accounts for those deals properly recorded.

³ Jon Henderson, Cullin B. Hughes, Madeleine G. Kline, Tanner L. Weigel, and Jacob A. Krysiak, “Health Care ‘Prime’: The Strategic Role of Systematic Health Care M+A in Remaking the Future of Health Care,” Polsinelli, 2018; Jon Henderson, Andrew Kinworthy, and Kevin McDonnell, “Health Care ‘Prime’ – The Shaping of Health Care in America Through M+A and Innovation,” Polsinelli, 2018; Jon Henderson and Andrew Kinworthy, “Health Care ‘Prime’: The Shaping of Health Care in Texas and Nationwide Through M+A and Innovation,” The Texas Law Book, Oct. 22, 2018; Mark Goran and Michael Dolan, “Shaping Health Care In America Through M&A And Innovation,” Law360, Nov. 13, 2018, <https://www.law360.com/articles/1100061/shaping-health-care-in-america-through-m-a-and-innovation>; “Health Care Prime: How Will M&A Shape the American Health Industry Going Forward? By Adhering to the Amazon Model,” U.S. News: Best Law Firms (2019), 36-37.

acquisitions strategy is the concept that companies strategically and repetitively executing a high volume of smaller deals tend to create more value over time than companies that only occasionally complete a large acquisition. Indeed, evidence shows that programmatic acquirers consistently outperform their peers in terms of overall growth and value generation⁴ when compared to occasional, high-profile mega-deals. This sustainable growth pattern continues even when businesses are rocked by recessions, a global pandemic, or more routine societal and economic downturns. We use the label “Systematic Health Care M+A” to describe the programmatic processes and systems through which acquirers are executing on their acquisitions of lower middle market health care businesses, including home-based care agencies.

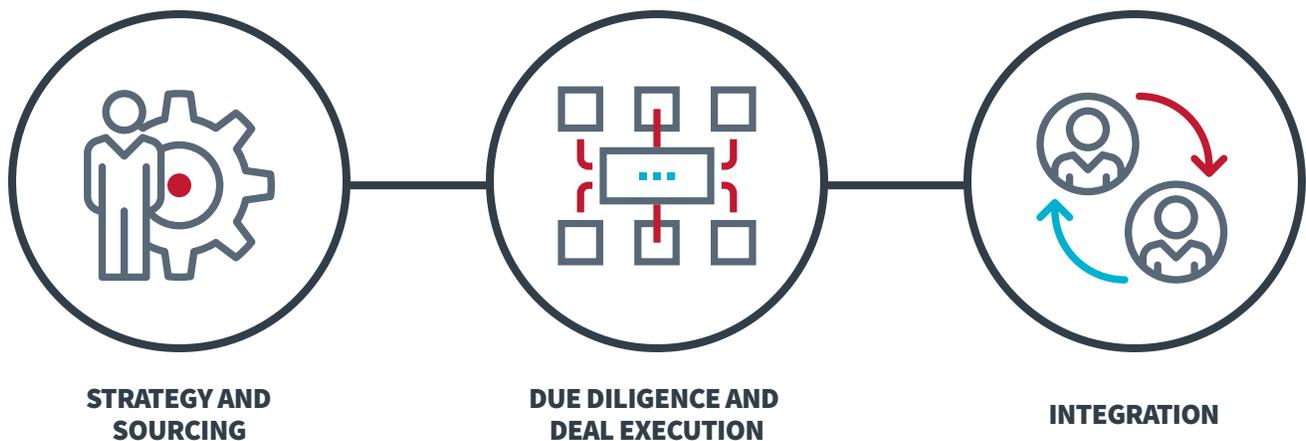
There are keys to successfully implementing Systematic Health Care M+A on the acquirer’s side, and being identified as an acquisition target on the seller’s side.⁵ Acquirers who engage in Systematic Health Care M+A are more likely to use strategic, specific practices at each stage of the acquisition process, and also as a means of maintaining what is known as the “M&A operating model.” The result is an efficient and consistent process that allows acquirers to identify ideal and practical acquisitions with efficiency, and streamline their acquisition processes.

Sellers also benefit from the use of this process-oriented approach which creates cost efficiencies that make smaller deals with smaller home-based agencies more feasible to complete

than in the past. The rise of serial acquirers within the home-based care market is opening previously closed doors to transact for smaller home-based care agencies who may not have previously had a viable succession strategy or exit plan. As the industry increasingly focuses on building and expanding national provider platforms capable of furnishing services across the full spectrum of home-based care, a plethora of options now exist for well-run, smaller agencies. For instance, some acquirers want to expand into a complementary service line or gain access to a care delivery program, obtain a new license type or expand into a new territory. In regards to ownership, some acquirers target owner-operators who are interested in selling a portion of the ownership of their business and continuing on for a set period of time or even permanently, while others are seeking a complete and immediate buy out. The variety available makes the lower middle market even more attractive to acquirers, and smaller home-based care agencies are receiving more attention in the deal marketplace than ever before, as they carry more intrinsic value to acquirers than they may realize.

An established systematic process saves both sides of an acquisition time and money by equipping both sellers and acquirers with goal-oriented strategies and criteria that are specifically tailored to their business. This article explores those strategies and the other key components of the programmatic mergers and acquisitions model being employed by savvy acquirers in consolidating middle market home-based care businesses and the steps a home-based agency may use to maximize the opportunity to transact with those acquirers.

M&A OPERATING MODEL



4 Oksana Kukurudza et. al., “The Role of Finance in Successful Serial M&A,” IMAA, <https://imaa-institute.org/the-role-of-finance-in-successful-serial-ma/>; Werner Rehm, Robert Uhlener, and Andy West, “Taking a longer-term look at M&A value creation,” McKinsey & Company, January 1, 2012, <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/taking-a-longer-term-look-at-m-and-a-value-creation>.

5 In 2018, there were over 11,300 Medicare-certified home health agencies, and one million people employed in home health services. In 2020, there were an estimated 400,000 home care-related businesses in the United States, with a market size of nearly \$97 billion. This number is only expected to increase as the elderly population increases, incidences of chronic diseases rise, and the need for cost-effective healthcare delivery becomes more prominent. “Home Care Providers Industry in the US - Market Research Report,” IBISWorld, Oct. 20, 2020, <https://www.ibisworld.com/united-states/market-research-reports/home-care-providers-industry/>; John Elflein, “Home care in the U.S. - Statistics and Facts,” Statista, July 28, 2020, <https://www.statista.com/topics/4049/home-care-in-the-us/>.

STRATEGY AND SOURCING

The first stage of the Systematic Health Care M+A approach involves developing a strategy for identifying deals and sourcing them appropriately and efficiently. Acquirers identify and utilize a defined set of criteria with a clear link to strategic objectives. This stage is an important part of the process because it allows acquirers to identify the most effective ways to strategically expand for value creation. In identifying such criteria and strategic objectives at this stage, acquirers may consider various factors impacting the enterprise value of the organization and attractiveness to a future investor, such as synergies with their existing operations, unique capabilities of the target's management team and clinical workforce, access to new payors or improved reimbursement rates, or improved positioning relative to existing competitors. Acquirers also consider the various limitations of pursuing certain deals, which allows them to avoid acquisitions that could negatively impact future value creation and opportunities for an exit transaction.

At this stage, programmatic acquirers also identify an organizational model that complies with applicable regulatory restrictions and is repeatable for effectiveness and scale while also being adaptable to the specific circumstances that a given acquisition and overall growth plans might present. This is an important exercise for acquirers because it allows them to easily eliminate potential acquisitions that are not compatible organizationally with their predefined strategic objectives. Important considerations at this stage include regulatory restrictions, licensure and certificate of need requirements, application of fraud and abuse laws, fee-splitting and other prohibitions that restrict who may own, refer to and from, pay compensation to and in what amounts, or employ or control the practices of licensed home-based care providers.

Programmatic acquirers also analyze growth opportunities to scale the new business, analyze the interrelationship between the target and existing service lines and the accretive impact of combining the same, and consider operational synergies not reflected in the book value of the transaction. For example, acquirers spend time early in this initial phase of a deal understanding the seller's business and confirming that the services and programs offered align with the care delivery the acquirer provides to patients. This allows acquirers to identify target companies that offer services which fit within the care continuum of the acquirer's other health services offerings, and highlights differences, such as contrasting payment models that might make the ultimate integration of the two companies practically impossible. By conducting a meaningful analysis of these factors at the early stages, acquirers are able to quickly identify and distinguish viable opportunities from discordant ones and focus their efforts accordingly.

Sellers similarly benefit from establishing specific goals and identifying potential acquirers at this stage. Considering market trends and operational alignment with other types of health care businesses allows sellers to value their business in ways that extend beyond mere revenue. Having conversations and exploratory meetings with prospective acquirers early and often

allows sellers to identify what acquirers are looking for in an acquisition and how to best position themselves for sale based on what is most attractive about their business in the eyes of prospective acquirers. This not only allows sellers to focus on the aspects of their businesses that differentiate them from other similar businesses, but it also ultimately makes discussions with potential acquirers more productive, and affords the sellers an opportunity to contemplate the best and most effective exit strategy.

In preparing for sale, sellers should consider what they can do to make their business attractive to potential acquirers from a practical standpoint. Implementing transparent and detailed policies and strategies for all facets of the business which allow the business to run efficiently and compliantly will be just as enticing to potential acquirers as the business itself.

Sellers should also contemplate not only what they want the future of their business to look like, but also what they want their roles to be with the business going forward. Whether it's remaining an active part of the business or exiting the business entirely, Sellers should have a plan for clearly communicating their intended goals and practical plans to both their employees and the acquirer, and should take time to consider the impact to their current staff, and how best to effectuate a smooth transition. Considering the best ways to implement these strategies greatly benefits sellers at both the diligence and integration phases of the M&A operating model.

DILIGENCE AND DEAL EXECUTION

After identifying target companies that meet their strategic, sourcing, and organizational goals, programmatic acquirers engage in an intentional, structured due diligence process to determine whether the target company is an optimal acquisition. A streamlined, efficient due diligence process is important for both sellers and acquirers to ensure that neither party is distracted or burdened by unnecessary diligence review, which can slow the transaction down or throw it off-course entirely.

Systematic acquirers at this stage are deliberate in employing strategies that gather relevant information about revenue, cost efficiencies, integration, and cultural and organizational fit. For instance, systematic acquirers typically begin their diligence process by utilizing a checklist of universal diligence items to collect from the seller, and issuing narrowly-tailored, targeted, industry specific diligence requests that prevent diligence from being overly burdensome, but that identify information about the services or products that allows the acquirer to better understand if the target will be an accretive acquisition and further their goals. To obtain such information, acquirers employ an appropriately-sized diligence team that have clearly defined roles and responsibilities. Acquirers also often utilize template agreements which are designed to fit the majority of deals but which can also be tailored for specific acquisition fact patterns. Acquirers have set timelines and phased milestones for each stage in the diligence process, such as for document review, the aggregating of diligence responses, and reporting on the results of their due diligence findings to key stakeholders. Acquirers with

the most mature processes at this stage will also organize the target's due diligence information in operations and in preparing for future transactions.

At this stage of the M&A operating model, sellers can expect to receive a rapid influx of diligence requests from quality of earnings, legal, insurance, employee benefits and other due diligence vendors engaged by the acquirer, and can best prepare for the diligence process by collecting as many relevant company documents as possible, including contracts with third parties (from staffing contracts to advertising contracts), the financials of the business, loans and other debt documents, organizational documents, employment agreements and company handbooks and policies, and licenses and governmental and commercial payor enrollments and contracts. In responding to diligence requests, sellers should prioritize transparency and expediency, and benefit from employing experienced counsel to guide them through the diligence process.

INTEGRATION

The integration stage of the merger and acquisition process is arguably the most important for programmatic acquirers. At this stage, acquirers consider corporate culture and organizational health, and spend time aligning people, getting buy-in from employees of the new and existing companies, developing and implementing compliance policies and practices, coordinating the operations of both companies, and developing measurements and criteria for success of the acquired company. This is important to acquirers because it identifies issues that might arise after the closing that could cause problems for the business, and it allows the integration of the target company in a way that maximizes the alignment of the target company's service offerings with the acquirer's overall care delivery model in a manner consistent with the goals and objectives identified in the first stage of the M&A operating model. In order to execute a successful integration, programmatic acquirers often develop their corporate departments to prepare their employees for the continued growth of the company (i.e., providing a playbook).

This has the benefit of maintaining employee morale and setting the stage for future acquisitions.

Sellers at this stage employ the integration strategies considered in the first stage of the M&A operating model, which often include clearly communicating expectations with their employees, being open to suggestions, concerns and criticism, and assisting the acquirer with incorporating their employees and business strategies into the new company.

CONCLUSION

Middle market deals make up an increasing share of home-based care business mergers and acquisitions, and the acquirers who are most successful in creating value through executing these deals are those applying Systematic Health Care M+A with defined processes and systems in place at each distinct stage of the merger and acquisition life cycle. The habits and practices of programmatic acquirers are more relevant than ever, and provide a reliable and effective approach to addressing various issues and considerations throughout the entirety of the acquisition process. Establishing these habits and practices early on allows both acquirers and sellers to position their businesses for either growth or sale by identifying the best growth pathway or exit strategy, preparing for the diligence process through disciplined and transparent strategies, and integrating their employees in a meaningful and efficient way. These habits and practices also enable sellers to focus on issues like compliance and maximizing their enterprise value, and allows acquirers to develop a consistent process for each stage of the merger and acquisition life cycle with an eye towards strategy and predictability, thus streamlining the merger and acquisition process in the future. These acquirers intentionally engage in Systematic Health Care M+A to establish a valuable, consistent and repeatable approach for managing their middle market home-based care business merger and acquisition activity and expanding their care continuum – a trend that will accelerate redefining the future of health care by encouraging innovation and ultimately enhancing patient care.



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