MERTZ TAGGART

HEALTHCARE MERGERS & ACQUISITIONS

VALUE INSIGHTS SERIES, ISSUE 3

IT'S ALL ABOUT THE MULTIPLE (…OR IS IT?)

I get asked all the time…*'what kind of multiple would my home care agency command?'*

'NOT SO FAST'…THERE'S NO STRAIGHT ANSWER.

I would go as far as saying it's irresponsible to give guidance simply in the form of a multiple without knowing the other half of the valuation equation – **Adjusted EBITDA.** The Adjusted EBITDA can be dramatically different depending on whether it is based on a trailing twelve-month (TTM) period, calendar year, annualized pro-forma, or some other formulation. It can also vary significantly based on the buyer and which adjustments will be considered.

The question should be, *'what kind of **VALUE** would my home care agency command?'* which is more complicated.

Let's take a step back and explain the value equation that is commonly used in the home care industry.

Value = (Adjusted EBITDA) x (the Multiple), whereby:

- Adjusted EBITDA (or **E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation and **A**mortization) is a proxy for "normalized" cash flow (normalizing for typical variations in a company's revenue cycle).
- The Multiple is the inverse of the go-forward risk of that cash flow continuing after the transaction is complete. The lower the risk of cash flow deterioration, the higher the multiple. For example, a 7x multiple implies a 14.3% return and a 5x implies a 20% return, so the 5x multiple is viewed as a riskier investment for the buyer, therefore he/she requires a higher rate of return.

Pretty straightforward, right? Well, not always. And here's why …**Adjusted EBITDA is in the eye of the beholder.**
Consider three case studies to illustrate:

continued on reverse →

ABOUT THE AUTHOR

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Cory has a track record of successful transactions within the rapidly changing home health and hospice industry. He has helped many entrepreneurs realize their exit planning goals, closing almost 60 home health and hospice transactions nationally since 2007.

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As a former home care company owner with many employees, Kevin understands all aspects of a healthcare company and the concerns facing the industry today. The sale of his company to a large publicly traded company uniquely qualifies him to represent you.

THE GROWING AGENCY

I represented the seller of a home care agency with the following value drivers:

- Trailing 12 months (TTM) revenue of $12,000,000;
- Trailing 12 months adjusted EBITDA of $2,200,000 (~18% of revenue);
- Strong growth;
- Multiple locations;
- Strong clinical and compliance program;
- Non-CON state; and
- Virtually no seasonality.

After receiving multiple bids, and after negotiations, the buyer came in with a valuation of $17,600,000. Clearly a healthy multiple of 8x ($17,600,000/$2,200,000), right? I can assure you the buyer was looking at this differently. Remember, this was a growing company that had no seasonality.

	Trailing 12 months (TTM)	Last 6 months, annualized
Revenue	$12,000,000	$14,400,000
Adjusted EBITDA	$2,200,000	$2,880,000
Multiple	7.3	5.6

So, what was the multiple? Depends on who you ask. The buyer was telling her board that they got this company for a steal – a multiple of 5.6. My client, the seller, was telling his golf buddies he sold for a multiple of 7.3x... **EBITDA & multiples are in the eye of the beholder.**

CORPORATE OVERHEAD AND SYNERGIES

Here's an example of a hospice we represented:

- Trailing 12 months revenue: $5,600,000;
- Trailing 12 months adjusted EBITDA: $800,000;
- Modest growth;
- Strong clinical and compliance program; and
- Non-CON state.

After running a competitive bid process, the buyer agreed to pay $5,600,000 (or about 1x revenue). This company commanded a multiple of 7, ($5,600,000/$800,000) right? Maybe/Maybe not...

In this case, the seller was paying an annual salary of $200,000 to a high-priced CFO who was not an owner of the company. Although he was instrumental in the success of the company, he was not needed by the buyer. This is typical, as nearly all strategic buyers have their own CFO who can take on these responsibilities. So the buyer would enjoy an immediate $200,000 bump in EBITDA on day one – to $1,000,000. To the buyer, this company was purchased for a multiple of 5.6x ($5,600,000/$1,000,000).

THE LOW MARGIN BUSINESS

Another example:

- Trailing 12 months revenue: $4,800,000;
- Absentee owner, not involved in the business; and
- Trailing 12 months EBITDA: $150,000.

The sale price was $2,400,000, or a multiple of 16 ($4,800,000/$150,000). Clearly not a standard industry multiple for a privately held home care agency, but it was a competitive process and the company had a high strategic geographical interest to the industry buyer. In this case, the buyer saw some "low hanging fruit" in the seller's cost structure and knew it could bring its EBITDA up to 12% (or about $600,000) very quickly. This included $220,000 in salary and "home office" expense enjoyed by the absentee owner who was not involved in the day to day operation of the business. In the eyes of the buyer, the multiple was a conservative 4x (or $2,400,000/$600,000).

So that begs the question…what is the multiple of a break-even (or money-losing) agency that sells for **any** price?

It's all about the **value.**