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5 MORE RED FLAGS IN URGENT CARE CENTER TRANSACTIONS

Written by Brittany Belli | Jan 23, 2015 | 0 Comments

This is part 2 of a 2-part series that The Ambulatory M&A Advisor is doing over the Red Flags Buyers don't like to see in M&A Urgent Care Transactions.

Urgent care center buyers can never be too cautious when it comes to making an acquisition. By analyzing any red flags that an urgent care center (UCC) displays, buyers can make smarter decisions. Part 1 of this series explained why unsophisticated legal and financial advisors, undesirable locations with low patient volume, regulatory action, cultural disconnect and poor management and staff were red flags in urgent care center transactions. Part 2 will explain five more red flags that stand out to buyers when considering an acquisition: adjusted EBITDA, consolidated financials, incorrect contracting of providers, bundled services and discrepancies in revenue.

Adjusted EBITDA

Bill Miller, CEO of CRH Healthcare, LLC and an operator that has completed three urgent care acquisitions in the last two years, says that as a buyer, he doesn't want to see an adjusted EBITDA that doesn't reflect the reality of the ongoing operations of the center(s).

"The organization will still need to market, be managed and pay owners-turned-employees," Miller says. Without these proper adjustments, it makes it difficult for buyers to get a sense of what a center's EBITDA actually is.

"Adjusted or normalized EBITDA could point to owners salaries/bonuses, rent above or below market value and legal issues, so it's important to understand the adjustments," Alan Ayers, Vice President of Corporate Development for Concentra Urgent Care, says.

"In urgent care, the relevant metric for valuation is mature-state EBITDA," Gareth Dickens, Co-Founder and Co-CEO of ConvenientMD Urgent Care, says. "As an acquirer, the only way you can buy into that method for valuing a center chain is to see that they have a solid number of centers that are actually delivering strong, mature-state revenue and EBITDA."

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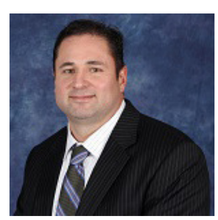

Blayne Rush

If it's hard for buyers to tell what the actual EBITDA of a clinic is, it may deter them from making the acquisition.

Consolidated Financials

"For multi-center opportunities, buyers don't want to see consolidated financials that make it unclear how one center is doing compared to others in the company," Miller says. "Consolidated financials are also a problem when centers are open for business during the review period as it can make more mature centers look less profitable, and newer centers look more profitable, if buyers don't have all of the details."

"In a lot of multi-center deals, sellers are looking to be paid for all of their centers, even if some of them are not mature," Dickens says. "Sellers will try to get a higher price for a less mature center, but in order to appeal to the buyers, they need to demonstrate that those centers are growing, and are on track to achieve strong, mature-state financial performance."

If buyers fail to dig deeper and uncover all of the center's finances separately, they could get stuck with an under-performing center that isn't worth the investment.

Incorrect Contracting of Providers

"Most small practices have a lack of, or incorrect, contracting of providers," Miller says. "This causes liability for the seller, as well as future work for the acquirer."

"Providers hired as independent contractors who are not appropriately classified as employees could result in understated personnel expenses," Ayers says.

Dickens also says it's important to check and see if the providers are required to be credentialed under the payor contracts.

"Depending on the UCC's contracts, some commercial payors are no longer requiring physician-based credentialing, and utilize streamlined facility-based credentialing processes instead," Dickens says. "It's not always a major red flag because there are different types of payor contracts, and poor credentialing is fixable, but it could turn into a major red flag if prior period revenue is at risk."

According to Ayers, understanding whether or not the providers, staff and/or owner(s) plan to remain with the practice is also critical. If additional staffing is necessary under new ownership, that may deter buyers from making an acquisition. If buyers will have to hire new providers and fix a poor credentialing process to get them contracted with payors, that is definitely a major red flag and buyers will be less willing to acquire.

Bundled Services

Sellers may think that performing extra services in their centers may increase their chances of making a sale, but that is a red flag to some buyers.

"As a buyer, I don't want to see other types of practices 'bundled together' with a UCC as an urgent care business," Miller says. "I acquire urgent care centers, not primary care practices, sleep evaluation practices or pain management practices."

"I have little interest in urgent care centers with additional services," Dickens says. "Healthcare is difficult enough for consumers to understand, and when centers start bundling services, it becomes even more difficult for a consumer to walk into a clinic and know what kind of treatment they can get."

Clinics that focus solely on urgent care can avoid some of the ambiguousness of performing multiple services.

"Certain buyers will look for 'pure-play' urgent care centers because that's the most straightforward and understandable format for the healthcare consumer," Dickens says.

If a clinic specializes in multiple fields, then consumers may become confused, and opt to go elsewhere. This will lower patient volumes, and raise even more red flags for buyers.

Discrepancies in Revenue

"If the collections-per-patient doesn't line up with, or come close to, what the revenue-per-patient booked is, that's a concern," Dickens says. "A seller may be overly optimistic in what the booked revenue is and inflate it, when they likely won't collect on the revenue that they've recorded."

"If the seller's gross revenue per visit (GRV) significantly exceeds the buyer's typical GRV, that could indicate an issue with coding," Ayers says.

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Dickens also says to pay attention to what a center includes in its patient volume. Sometimes, patient volume includes low-priced sports physicals, free flu shots and other campaigns that the clinic will run.

"Buyers will need to make sure that the patient volumes that the clinics are generating are volumes that will turn into revenue, rather than low reimbursements or free services," Dickens says. "You have to be wary of pricing for different service levels."

"The buyer should understand and verify the visit volumes," Ayers says. "Applying the volumes to the buyer's normal practice patterns should provide a certain level of confidence that the practice can produce the desired result."

Retaining providers after a sale is also important for avoiding discrepancies in revenue.

"After a transaction, the physician owners who were responsible for driving volume, treating patients and generating revenue could leave post-close," Dickens says. "That's what I call 'elevator risk.' If those providers leave, that's a significant problem to the future of the clinic."

In order to avoid this potential problem, Dickens says buyers can have the physician owners sign a non-compete, non-solicit contract with provisions that they will continue to work at the center after the transaction is complete. In addition, buyers can negotiate hold-backs of a portion of the transaction proceeds. These hold-backs can be released after physician owners have continued to work in the acquired clinics for an agreed period of time post-closing. This can help prevent a large discrepancy in revenue after an acquisition.

In M&A urgent care transactions, buyers will have to sift through a lot of red flags to determine if a center is worth acquiring. But taking the time and effort to do so will result in a smarter acquisition decision.

"Red flags create uncertainty," Ayers says. "The buyer wants to ensure that the acquired practice performs as expected, so eliminating as much uncertainty and validating assumptions through intense due diligence is critical for a successful acquisition."

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