Selling your Company

What to Expect

Presented at the 2019 Rocky Mountain Home Care, Home Health, and Hospice Conference

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Experience
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- University of Chicago, MBA
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- OrthoColorado Hospital, Board Trustee
- Omega Hospital, Board Director
- Livestock Labs, Board Director
- Diathrive, Board Director

Representative Transactions
- Colorado Homecare Agency
- Healthcare SaaS Company
- Surgical Hospital
- [Representative Transactions Logos]
Capital Markets Update

Commentary and Insights

- In 2018, the stock market had its most volatile year in recent history, however, in 2019 it continued its climb to all-time highs.
- Many institutional investors remain bullish as they see a high-growth economy, low inflation and low unemployment. A rare combination.
- Treasury bonds remain at historical lows, keeping corporate debt rates at attractive borrowing levels.
- But after a 10-year economic expansion a recession is due.

Merger and Acquisition Dynamics

Middle Market EV / EBITDA Multiples

Commentary and Insights

- M&A activity remained strong in 2018, with the second-highest total deal value on record.
- The average Enterprise Value(EV) / EBITDA multiple rose to 7.2x, driven by buyer competition and plentiful institutional capital.
- Private equity firms and strategic buyers continued to enjoy relatively inexpensive debt for their transaction financing.
- Middle market private equity firms raised over $100 billion last year.
Homecare Public Equity Performance

- Homecare and hospice public companies have significantly outperformed the S&P 500.
- Over the past 5 years, the total growth rate and compounded annual growth rate (CAGR) are provided below:

<table>
<thead>
<tr>
<th></th>
<th>Total Growth</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amedisys</td>
<td>691%</td>
<td>68%</td>
</tr>
<tr>
<td>LHC Group</td>
<td>452%</td>
<td>53%</td>
</tr>
<tr>
<td>Addus</td>
<td>204%</td>
<td>32%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>50%</td>
<td>11%</td>
</tr>
</tbody>
</table>

Homecare and Hospice Investment Trends

- Homecare consolidation activity has accelerated in recent years, driven by several dynamics:
  - A continued emphasis on outpatient care to reduce overall healthcare costs.
  - The need for operational scale and efficiency during the transition from fee-for-service to value-based payment models.
  - Homecare agencies beholden to one or two payor sources face “stroke-of-pen” risk. Consolidation is a method to diversify revenue and lower risk.
  - CMS’s 2013 moratorium on new HHA enrollment in certain markets effected a 5-year decrease in total HHAs. Investors and buyers were pursuing a shrinking pool of targets.
  - Valuation multiples in the homecare industry remain attractive, bringing “on-the-fence” sellers to the market.
- Hospice M&A activity has also increased, driven largely by the increase in for-profit providers. Between 2010 and 2017, over 1,000 new for-profit providers were established. The investment community now views the hospice industry as ripe for consolidation.
Private Equity Healthcare Trends

- Private equity firms have significant "dry powder" and an increasing number are solely focused on middle market healthcare service transactions.
- 42% of healthcare transactions in 2018 involved a private equity firm.
- With new institutional investors in the space and highly favorable macro drivers, this high activity level will likely persist for the foreseeable future.
- In particular, private equity investors are seeking fragmented healthcare service platforms to buy-and-build scale and operational efficiencies.
- In addition, they try to identify opportunities for expansion in geography and services in order to limit their exposure to payor and reimbursement risk.

Private Equity Home Health & Hospice Trends

Home Health & Hospice Buyer Types
- In 2018, PE firms accounted for almost 60% of transactions while private and public strategic operators accounted for almost 40%.
- Over 50 PE firms made acquisitions in 2018.

Private Equity Objectives
- PE firms in the home health and hospice space tend to pursue a platform-building strategy, taking advantage of the arbitrage opportunity between the higher valuations typically commanded by larger home health and hospice agencies (>-$5m in revenue) and the lower valuations for smaller agencies.
- PE firms targeting home health agencies are looking to take advantage of perceived inefficiencies in site of care economic differentials. They aim to capitalize on changing reimbursement models which focus on value of care, rather than frequency of care.
- Additionally, as Medicare and private insurers continue to push towards lower cost care settings, PE firms aim to capitalize on increasing home health volumes.
Determining When to Sell

Market Dynamics: A macro analysis of M&A activity and current valuations.

Company Preparedness: A micro analysis of your company’s operating performance, systems, and growth. Selling with 20% to 25% prior-year growth tends to maximize a seller’s valuation.

- Lower growth will decrease valuation multiples
- Higher growth will be difficult to sell on and may result in earn-out or contingent payment arrangements

Seller Objectives: A meta analysis. Using your instincts to know if you are ready for a sales process. It’s not for the faint of heart and it’s difficult to watch your “baby” be poked and prodded.

Speak to Experts: Find an experienced and knowledgeable M&A advisory firm or broker to speak with before you’re ready to sell.

Budget for Pre-Process Work: Cleaning up issues before a process starts will save time, increase the certainty of deal-closing, and increase valuation.

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What are Your Exit Options

Business owners have limited options when exiting.

<table>
<thead>
<tr>
<th>Transition</th>
<th>Advantages</th>
<th>Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale to a third party</td>
<td>- Most likely to yield highest value</td>
<td>- Lack of familiarity</td>
</tr>
<tr>
<td></td>
<td>- May have good management skills</td>
<td>- Discontinuity</td>
</tr>
<tr>
<td>Sale or transfer to family members</td>
<td>- You know the buyer – more certainty, less risk of surprise</td>
<td>- Can they run it?</td>
</tr>
<tr>
<td></td>
<td>- You’re giving them something to do</td>
<td>- Can you leave it alone?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- How do they pay for it?</td>
</tr>
<tr>
<td>Sale to management / employees</td>
<td>- You realize tax benefits with an ESOP</td>
<td>- Can they manage it?</td>
</tr>
<tr>
<td></td>
<td>- Employees have enthusiasm and ties to business</td>
<td>- How will they pay for it?</td>
</tr>
<tr>
<td></td>
<td>- Continuity</td>
<td>- Will you receive full value for your share?</td>
</tr>
<tr>
<td>Close the doors</td>
<td>- Simple way to exit</td>
<td>- No value or liquidity</td>
</tr>
<tr>
<td></td>
<td>- Can be stress free</td>
<td>- Employees lose jobs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Exposure to potential liabilities</td>
</tr>
</tbody>
</table>
Overview

For the purposes of today’s presentation, we are focused on third party sales and have segmented the transaction process into the following four categories:

- Preparation for Sale Process
- Sale Process – Marketing
- Sale Process – Final Offers
- Closing Documents

Roles of Advisors Through the Process

<table>
<thead>
<tr>
<th>Investment Bankers</th>
<th>Lawyers</th>
<th>Other Providers</th>
</tr>
</thead>
</table>
| **Preparation for Sale Process** | - Preliminary business evaluation  
- Assess valuation/financial alternatives  
- Prepare confidential memorandum  
- Identify potential buyers / investors | - Preliminary legal due diligence | - Preliminary accounting due diligence  
- Assess need for audited financial statements  
- Consider Q of E Report |
| **Sale Process – Marketing** | - Market company to potential buyers  
- Facilitate auction process  
- Field initial indications of interest | - Draft and negotiate non-disclosure agreements | - Choose electronic data room provider |
| **Sale Process – Final Offers** | - Coordinate management presentations  
- Coordinate due diligence process  
- Assess credibility of offers, including financing | - Advise on letter of intent  
- Legal due diligence | - Industry research / consulting  
- Accounting diligence  
- Clinical diligence |
| **Closing Documents** | - Advise on transaction structure | - Draft purchase and ancillary agreements  
- Draft disclosure schedules  
- Review employment agreements |
Timing of Process

On average, the transaction process takes between 6 and 9 months:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Elapsed time (week)</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Elapsed time</td>
<td>Month 1</td>
<td>Month 2</td>
<td>Month 3</td>
</tr>
</tbody>
</table>

Deal Killers

Throughout today’s presentation, I will periodically mention “Deal Killers.”

The purpose for doing this is to identify the points that can more negatively impact a transaction and help you better prepare.

The sign below indicates we are discussing a crucial deal point.
Determine Sale Strategy

The major objective of the sale process is to create competition among interested buyers.

- What attributes of the business will potential buyers find most appealing?
- How many potential buyers should be invited to the process?
- Each buyer group should feel that they are competing against other viable bidders, but that they have a good chance of winning.

Strategic vs. Financial Buyers

Sellers should understand the differences between strategic and financial buyers.

<table>
<thead>
<tr>
<th>Groups</th>
<th>Strategic</th>
<th>Financial</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public company</td>
<td>Private Equity / Venture Capital</td>
</tr>
<tr>
<td></td>
<td>Private company</td>
<td>Hedge Fund</td>
</tr>
<tr>
<td>Goals</td>
<td>Use target's strengths to enhance current operations, reduce competition, economies of scale</td>
<td>Improve operations of target to eventually make an &quot;exit&quot; and earn attractive return on investment</td>
</tr>
<tr>
<td>Investment Timeline</td>
<td>Indefinite</td>
<td>Typically 5-7 years</td>
</tr>
<tr>
<td>Funding</td>
<td>Cash or company stock</td>
<td>Cash / debt leverage (from fund equity and lenders)</td>
</tr>
<tr>
<td>Management</td>
<td>Replace current management with buyer's own staff</td>
<td>Retain existing management, usually encouraging management to invest in new equity</td>
</tr>
<tr>
<td>Pricing</td>
<td>Historically higher than financial buyers, as they can pay a premium for synergies</td>
<td>More disciplined about purchase price in order to hit return metrics, but there is increasing pressure to put capital to work</td>
</tr>
</tbody>
</table>
Understanding Valuation Drivers

Understanding what drives and creates value in a business can help a seller better prepare.

- Advisors to seller should perform due diligence to best position strengths and weaknesses
- Each potential buyer will weigh qualities differently

<table>
<thead>
<tr>
<th>Management</th>
<th>Financials</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry experience</td>
<td>Steady, sustainable growth</td>
<td>Industry leading practices</td>
</tr>
<tr>
<td>Creativity</td>
<td>Strong margins</td>
<td>Compliant systems</td>
</tr>
<tr>
<td>Vision / Strategy</td>
<td>Cost controls</td>
<td>Growing service opportunities</td>
</tr>
<tr>
<td>Forecasting strength</td>
<td>Strong financial performance during transaction</td>
<td>Referral diversity</td>
</tr>
<tr>
<td>Dedication to business plan</td>
<td>Ability to meet projections Dealt</td>
<td>Payor / Revenue diversity</td>
</tr>
<tr>
<td>Personal fit with buyer</td>
<td></td>
<td>Geographic diversity</td>
</tr>
</tbody>
</table>

“Quantitative” Valuation Drivers

1. Publicly Traded Comparable Companies
   Utilizes market trading multiples from publicly traded companies to derive value

2. Comparable Acquisition Transactions
   Utilizes data from M&A transactions involving similar companies

3. Discounted Cash Flow
   Analyzes the present value of a company’s free cash flow

4. Leveraged Buyout Analysis
   Used to determine range of potential value when leveraging with debt

Note: Asset Approach is also a common approach not highlighted on this page, mainly because it’s a fairly simple calculation and easy to understand.
“Qualitative” Valuation Drivers

- Capital Markets Conditions
- Reputation & Track Record
- Scalable Growth Story
- Corporate Structure
- Seller Flexibility in Transaction
- Management Team Capabilities & Depth
- Audited or Reviewed Financials
- Payor Concentration
- Consistent Financial Results

Determine Sale Strategy

How broad should a process be?
- Evaluate market conditions
- Determine owner and management time availability
- Consider sensitivity to confidentiality

Number of Offers Received
- Affects ability to maximize value and negotiate terms

Number of Potential Buyers Invited into Sale Process

- Broad Marketing
  - Provides seller with the maximum number of alternatives to weigh
  - Higher likelihood of finding "the needle in the haystack"
  - Management is initially less involved in marketing process
  - Gives shareholders confidence that maximum value has been achieved

- Targeted Marketing Process
  - Creates a streamlined, but still competitive process
  - Management is partially involved in initial marketing

- Exclusive Negotiations
  - Negotiate price and terms with single buyer
  - Single buyer reduces seller’s negotiating leverage
## Reviewing Initial Indications of Interest

**Factors to consider:**

**Financing**
- Will the financing terms proposed in the offer be achievable?
- Will the seller have to assume more risk than desired?
- Is the seller comfortable with the proposed level of debt or stock valuation of strategic acquirer?

**Structure**
- Will the structure of the proposed offer achieve the mutual long-term goals of the buyer and seller?
- Is the structure in line with current market standards?

**Reputation / Seriousness**
- Is the buyer / seller committed to seeing the deal to closing?
- Are the goals of the buyer post-closing achievable, or will it overly pressure current management?

## Financing the Deal

**Pre-Transaction:** Company’s value is its “Book Value,” the worth of its assets less the value of its debt and liabilities

**Transaction:** As a result of a transaction, the company’s value increases beyond its Book Value and shareholders receive consideration for their equity, or “Goodwill”

**Post-Transaction:** In order to purchase the Company for the amount they bid, many buyers will leverage the company and fund its capital structure with a combination of equity and debt

<table>
<thead>
<tr>
<th>Total Value</th>
<th>Senior Debt</th>
<th>Mezzanine Debt</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$150</td>
<td>0%-20%</td>
<td>40%-50%</td>
<td>40%-50%</td>
</tr>
<tr>
<td>$50 Goodwill</td>
<td>40%-50%</td>
<td>0%-20%</td>
<td>Revolver</td>
</tr>
<tr>
<td>$100 Book Value</td>
<td>0%-20%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Management Presentations

After initial indications of interest are received, the seller’s management will typically meet with a select number of bidders.

- Number of potential buyers invited will depend on range of offers and management’s availability.
- Management presentations can greatly impact the quality of final offers and valuation level.
- Buyers will have the opportunity to ask sellers face-to-face about their vision and strategy.
- Sellers will get a feel for buyers and how they operate.
- This process begins the buyer group’s initial diligence phase, so they will begin to ask very detailed questions that will directly shape their final proposal.

Due Diligence

After management presentations, the seller will choose “finalists” who will then be invited to conduct extensive due diligence.

- The buyer group must keep their advisors organized to ensure that they gain the information needed to close the deal.
- The seller must keep the flow of information timely and organized to ensure the buyer group keeps to their transaction timeline.
- Advisers need to help each side determine which information is most pertinent to the transaction so neither side gets caught up in a relatively small issue.
- Once this phase is complete buyers will submit final proposals, typically in a Letter of Intent.
Nonbinding Letter of Intent

**Buyer’s Responsibilities**
- Valuation proposal and transaction structure (e.g. stock vs. asset)
- Financing plan and contingencies
- Due diligence timeline and milestones
  - When will clinical diligence be completed?
  - When will accounting diligence be completed?
- Final agreements, legal work timeline
- Commit to pay 100% of their transaction costs
- Recomit to confidentiality

**Seller’s Responsibilities**
- Agree to valuation proposal
- Grant “buyer exclusivity” for a period of time, typically 90 to 120 days
- Access to company information and key employees in a timely manner
- In certain cases, access to key referral sources or revenue sources (at the very end of the timeline)
- Agree to work expeditiously with regulators
- Confidentiality regarding the buyer and deal terms
- Commit to pay 100% of their own transaction costs

Asset vs. Stock Deals

**Asset Deal**
- Buyers typically prefer asset deals.
- If a buyer acquires company stock, any past misdeeds of the company are a liability for the new owner.
- With an asset deal a buyer can avoid successor liability.
- Buyers can purchase the good assets and leave behind the bad assets and some (or perhaps all) of the liabilities.
- Usually a buyer does assume certain liabilities related to working capital.
- Asset sales are cleaner logistically and easier to document.

**Stock Deal**
- Sellers typically prefer stock deals.
- Asset deals pose the risk to sellers of double taxation.
- Proceeds from the sale first go to the company, which may have to pay a capital gains tax.
- The remainder of the proceeds are paid to the owners, who in turn may have to pay tax on that after-tax amount.
- In a stock sale owners of the company sell shares to the buyer and in most cases face just one layer of tax (which is hopefully the capital gains rate).
- In some cases buyers will increase the purchase price to offset the higher taxes of an asset deal.
Final Deal Documentation

Sellers should use legal counsel experienced with healthcare service transactions. Key documents:

- Purchase Agreement
- Shareholder Agreement (Stock Sale)
- Disclosure Schedules
- Employment and Option Agreements
- Non-Compete Agreements
- Voting Agreements (mergers)
- Landlord & Other Third Party Consents
- Regulatory Approvals

Key Documentation Points

**Purchase Price Considerations**

- Fixed $ amount
- Fixed $ amount, subject to adjustment
- Cash vs. escrow
- Earn-outs and contingent payments
- Deferred payments / seller notes
- Buyer’s stock

Legal Provisions

- **Representations and Warranties**: the purchase agreement will contain a comprehensive list of seller reps and warranties
- **Escrow/Indemnification**: most buyers require that a % of the purchase price be placed in escrow at closing for any breach of representations

**Other Important Considerations**

- Working Capital
  - A healthy level of working capital is built into the purchase price.
  - Usually the final purchase price is adjusted based on working capital at close compared to the pre-negotiated target amount.
- Most deals are completed on a “debt free” and “cash free” basis. Meaning the seller would keep existing cash on the balance sheet.
- Equipment
- Real Estate
- Closing Conditions
Let’s Review

**Deal Killers**

- Seller misses budget / goals during sale process
- Buyer and Seller negotiate one-on-one, but break off process when they disagree over an issue
- Seller’s management discovers they won’t be retained after transaction
- Seller is enamored by high bidder, but buyer’s financing does not come through

**The Fix**

- Set realistic / conservative budget before marketing process begins
- Understand exclusive negotiation risk and allow advisors to be intermediaries
- Best to have process that is “just right” - not too big or too small
- Understand the difference between strategic and financial buyers’ objectives
- Understand the financial structure’s impact on valuation - a $10 million bid is not necessarily better than one for $9 million

Deal Killers

The Fix

Preparation for
Sale Process

Sale Process -
Marketing

Sale Process -
Final Offer

Closing
Documents