What's It Worth? A Guide to Determining and Increasing the Value of Your Home Care Business

When planning for your eventual exit from your home care business, determining how much a buyer will pay to purchase the business is critical. Often home care business owners have put decades of time, energy, and resources into founding and growing the business, and it can be an emotional process to assign a monetary value to your efforts. Unfortunately, most business owners don't have a good sense of what their business is worth, and letting emotions drive the process can set the stage for difficult negotiations and disappointment.

This guide explains the process used to estimate the value of a home care business. It walks you through:

- **Materials**
  The materials you'll need to prepare to ensure that the value of your home care business can be properly calculated
- **Factors**
  The different factors that impact the value of home care businesses
- **Basics**
  The basics of how a business' value is calculated
- **Increase Value**
  Ways to increase the value of your business and better meet your financial goals

What Is Business Valuation?

Technically speaking, business valuation is a process used to identify what an interested and informed buyer would be willing to pay to acquire certain assets from an interested and informed seller. Practically, it is the process of trying to reach agreement on how to best satisfy the goals of both parties involved in the transaction.

> **Valuation is a process of understanding what your business is worth, based on how much profit it can be expected to generate in the future.**

Thinking about retirement? Understanding the value of your business can help you identify if there is a gap between what your business is currently worth and the price you need to meet your financial goals for retirement.

There are multiple approaches to business valuation, but all approaches assume that an individual purchases a business for the primary reason of generating wealth, which is measured as business profits. Therefore, a buyer will consider how much profit the business has generated historically, and its ability to generate profits in the future.

Business valuations are most commonly used to estimate the selling price of a business. The final sale price might not equal the number determined by the business valuation, but the valuation provides a benchmark for the buyer and the seller as they negotiate a sale price.

A business valuation can provide you with useful information even if you do not have intentions of selling your business soon. A valuation identifies the gap you need to fill between today's value and the value you need when you exit. Additionally, having a general understanding of the value gives you a roadmap for making business improvements and other strategic decisions.

To produce a detailed and objective valuation of your business, you might need to work with a qualified, impartial third party. The scope and cost of a valuation depends on the size and complexity of the business and the purpose of the valuation. Before hiring a professional to complete a valuation, it is important to articulate why you are seeking a valuation and how you will use the valuation.

Preparing For Your Company's Valuation

Once you've begun thinking about selling your home care business, you need to prepare the appropriate materials so that an accurate valuation can be completed. It's not necessary to have all of this information ready before you start the process, but the following information is essential to complete a valuation and formalize a plan for selling your business. Even if you're just beginning to think about the process, this checklist can come in handy to prepare your business down the line.

- **3 to 5 Years of Financial Statements and Tax Returns**
  While audited statements are preferable, statements prepared by management also work.

- **An Up-to-Date Business Plan or Marketing Plan**
  Accurate earnings projections are key to establishing the business value based on its income.

- **Business Operating Procedures**
  The more detailed, the better. These make it easy to understand how the business works, who does what, and what skills are required.

- **Customer List, Vendor Contracts, Leases**
  It's important to be able to "check under the hood" of the financial statements to ensure that the projections are realistic.

- **Legal Paperwork**
  You'll need to amend the articles of incorporation and by-laws, so it's important to know how things are structured and governed now.

- **A List of Key Managers and Staff**
  It's especially important to understand who will be taking a leadership role in the company going forward.

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Questions any business owner should ask themselves

Understanding all the factors that impact your company's value can help you make business decisions that will preserve and increase the value where you can. Minimizing risk for the buyer by preemptively adjusting any of the following factors can increase the likelihood of you achieving your exit goals.

- **How concentrated is the market that my business operates within?**
  Understanding the context that your business operates within is crucial for establishing value. This focuses primarily on your business' most direct competitors, as well as current and future clients and caregivers. Regardless of the other options in the market, key differentiators that naturally drive clients and caregivers towards your business will help convey earnings and expansion potential for any prospective buyer.

- **What role does the location of my business play?**
  Operating within a high concentration of clients and caregivers reduces expenses associated with caregivers traveling farther distances in between clients. As a result, shorter travel distances optimize caregiver schedules so they are able to capture the total client hours available to the agency each day. These efficiencies provided by an agency's service area can demonstrate the potential for growth and ability to expand to farther markets when ready.

- **How diversified are my revenue sources?**
  A mix of revenue sources, such as a distribution of managed care organizations, private pay clients, and/or care coordination fees, can both increase your total revenue and minimize risk if any of your revenue sources temporarily or permanently disappear. Similarly, diversifying and expanding your services to include skilled and specialized care allows clients to remain with your agency as their needs change. It is important to show strong collections systems and that your business is regularly receiving a high percentage of the money it is owed.

- **Will my clients keep their business at the company after I leave?**
  Ensuring that clients are loyal to your agency beyond their relationship with you as the owner, and that they will remain customers after you leave, is crucial to convey to any prospective buyer. Ensuring that agency managers and caregivers have strong relationships with clients and their families and are continuously happy with the quality of care provided are two ways to build loyalty and commitment to the agency.

- **Will my staff stay on after the sale?**
  Prospective buyers will want to know that the business will continue to run smoothly without you in charge. Committed caregivers and a strong administrative team who are able to keep operations running with little interference from the owner will increase buyer confidence. Additionally, maintaining and demonstrating a low caregiver turnover rate will be a competitive advantage in today's market.

- **Are my financials clean and up to date?**
  Ultimately, a buyer will want to understand how your company performs financially. Being able to provide clear and up to date financial records for the past 3-5 years will provide a buyer with the information they need to most accurately estimate the value of your business.

Lower Demonstrated Risk = Higher Value

Demonstrating to a prospective buyer that the business' earnings will continue after your exit decreases the perception of risk.

How Are Valuations Conducted?

Most home care businesses are closely held companies and determining the value of a closely held company is difficult and an imprecise science. There are multiple methods, each with their own strengths and weaknesses. Given this, it is best to understand the range of value that can be reasonably estimated from multiple approaches.

There are three general approaches to business valuation:

1. **Market based valuations**
2. **Income based valuations**
3. **Asset based valuations**

> **Valuation isn't an exact science. It's best to understand your business value as a range of reasonable values estimated from multiple approaches.**

The examples provided in this guide illustrate the process for using these approaches to determine the "enterprise value" of a business, or the cash-free, debt-free value of the business. Because the enterprise value does not include the cash a company has in its bank account or any long-term debt, it's a useful metric to compare companies of different sizes and industries.

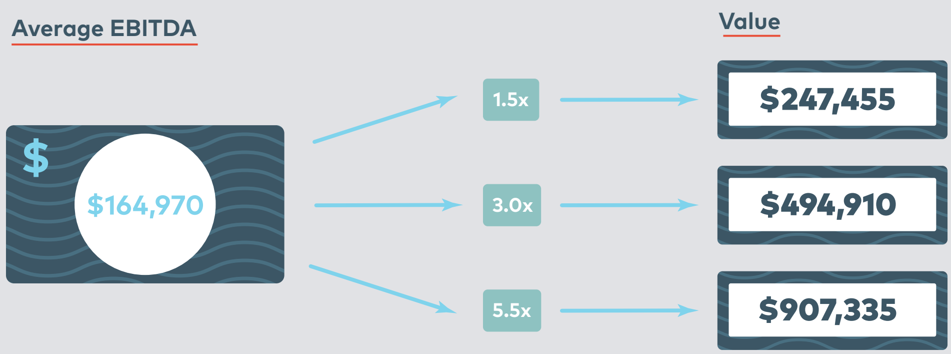
❶ **Market Based Valuations** seek to determine the value of a business by analyzing the values of similar home care businesses, to determine what others in the market are willing to pay. A multiple of earnings or cash flow is often used to determine the market value of a business. For example, a company's value might be calculated by multiplying its earnings before interest, taxes, depreciation, and amortization (EBITDA) by an amount in proportion to similar firms.

EBITDA stands for:

E	B	I	T	D	A
Earnings	Before	Interest expense for outstanding loans	Taxes	Depreciation of assets	Amortization of intangible assets.

This simplified EBITDA method is illustrated below for a home care business that had an average EBITDA of $164,970 over the last four years. You can see that because the span of EBITDA multiples is so wide, an agency with a similar EBITDA can result in multiple different valuations based on the factors that measure risk mentioned before—location, market concentration, client loyalty, etc.

A multiple, or capitalization rate, compares two metrics as a ratio, such as the ratio of the sale price to the company's earnings. For example, if the earnings multiple for similar businesses is 3 and the earnings of the business being valued is $100,000, the earnings multiple suggests that the business may be valued for a sale of $300,000 ($100,000 x 3).



While this method benefits from being simple, it can be challenging to find useful market data due to the wide size ranges of operational home care agencies. As a starting point, most small- to medium-sized service businesses sell for 2 to 4 times their EBITDA. The low multiples are indicative of the perceived risk of the industry. In essence, multiples attempt to quantify the risk associated with the purchase of a business, and have an inverse relationship to the risk perceived by the buyer.

Higher Multiple = Safer Purchase

A seller will need to demonstrate efficiencies, profitability, stability, and potential for growth in order to warrant higher multiples.

The home care industry is fragmented, saturated, and largely bifurcated between large and small agencies. Therefore, available sale data on value has a wide variance, multiples that range from 1 to 7 times EBITDA. However, the ratio of value to Seller Discretionary Earnings (SDE) are much tighter and provide a clearer picture of a firm's value.

How is a seller tied to the value of the business?

Seller Discretionary Earnings

As closely held businesses, home care agencies are often financially tied to the owner. Seller's Discretionary Earnings, or SDE, is the calculation of this total financial benefit that a single owner-operator derives from a business on an annual basis. It is calculated by adding owner compensation for one full-time owner to adjusted EBITDA.

EBITDA		**$164,970**	
Seller Replacement Costs	**-$40,000**		**$0**
Adjusted EBITDA	**$124,970**		**$164,970**
Owner Compensation Add Back		**+$60,000**	
SDE	**$184,970**		**$224,970**
Possible SDE Multiples			
1x	**$184,970**		**$224,970**
1.5x	**$277,455**		**$337,455**
2x	**$369,940**		**$449,940**

SDE does not necessarily change the value of the business; rather, it is a different measure of earnings that can be used in calculating value. SDE adds another data point to the valuation process that can more clearly communicate the total financial benefit a potential buyer could expect to receive as the new owner and operator of the business. Just like there are EBITDA multiples, there are separate SDE multiples for calculating value. SDE is often a larger value than EBITDA and SDE multiples are lower than EBITDA multiples.

❷ There are two types of **Income Based Valuations**, both based on the idea that the best way to determine a company's value is to determine how much cash it can produce in the future. These methods are used when:

- **The company's earning capacity contributes significantly to the value of the company**
- **The company has intangible asset value**
- **Significant value is added to the company's services through labor**
- **The company has positive earnings**
- **Expected growth is predictable**

The two methods are the **capitalization of cash flow method**, which looks at the current annual cash flow for the company, and the **discounted future cash flow method**, which is based off of projections of how the business will perform in the future.

Using the discounted future cash flow method, a business appraiser would forecast financial performance for a "forecasting period" which is based on the length of time it takes for the business to reach maturity, or a steady state of revenues or profits. Home care businesses with an operating history are likely at maturity, meaning the forecasting period might only be one year. Projections are then used to determine what cash flows (income) a buyer can expect from the business, and then discounts these cash flows at a required annual rate to arrive at an estimate of present value.

❸ An **Asset Based Valuation** focuses on the company's balance sheet and is based on the idea that the company's value is equal to the underlying value of the company's net assets, which is also referred to as book value. Book value is calculated as:

Total Assets – Total Liabilities = Book Value

For home care agencies, their core operation is providing services to clients via their workforce, rather than the production of goods. Accordingly, most home care agencies have few tangible assets, and the asset approach is therefore not the most appropriate method for valuing home care agencies. However, an asset based valuation could be used when the company does not have an established earnings history, or if it consistently has had negative earnings and the value of its earnings is less than the value of its tangible assets (such as furniture, equipment, and cash in the bank).

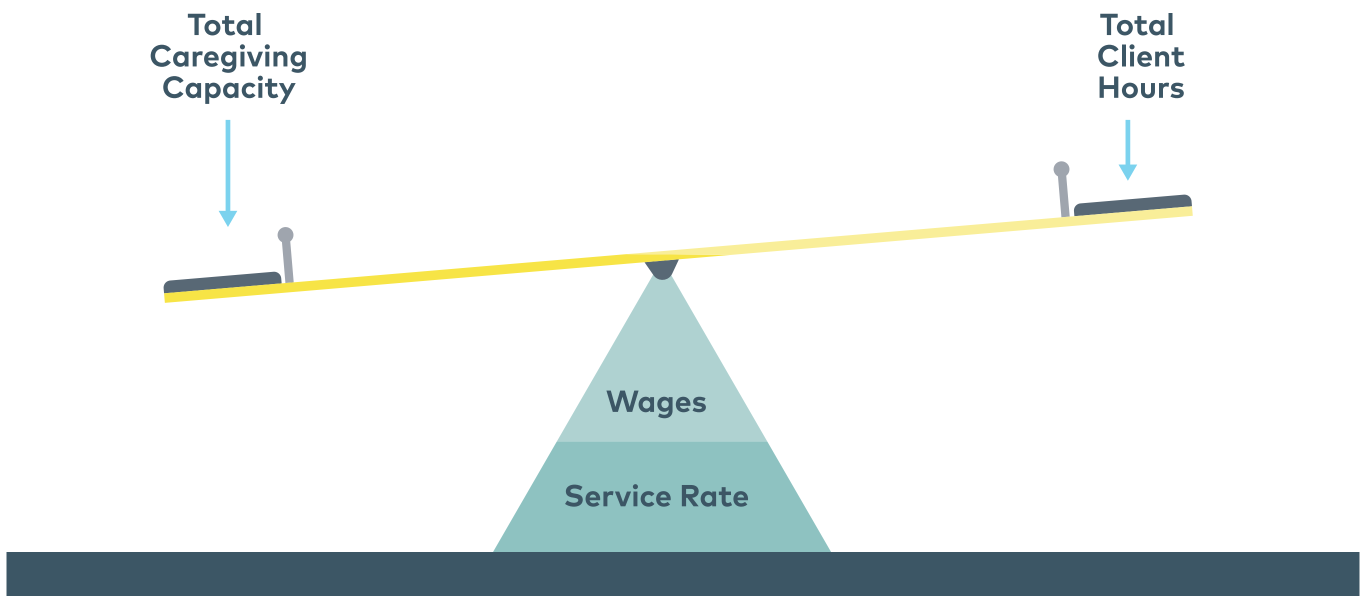
When is $200,000 Worth $220,000? Transaction Structure and Business Value:

The Market Value of Invested Capital (MVIC) refers to the total compensation that is paid to the seller and includes any cash, notes, and/or securities that are used as a form of payment for the business. The structure of the transaction influences the MVIC. For example, if you sell your business to someone who pays 100% of the selling price in cash, that cash amount is your total MVIC. But, most sales of businesses include seller financing, which means the buyer pays the seller in installments over time. The terms of seller financing, including the interest rate and repayment period, are negotiated between the buyer and seller. In that scenario, your MVIC would include both cash payments and interest payments you receive from the buyer.

Imagine your home care agency has $100,000 in EBITDA, and you think it is worth $200,000. One buyer offers to pay you $150,000 in cash. A second buyer offers to pay you $50,000 in cash and an additional $150,000 over the next three years out of the agency's profits.

Which option is better for you? With the first buyer, you would receive $150,000 all at once. With the second buyer, you would receive approximately $220,000 as cash and interest payments. While the second option directs more money to you, it also has more risk: if the business doesn't turn profits after the sale, you'll only receive the initial $50,000.

Financial Metrics That Impact Business Value



❶ Total Caregiving Capacity

Total caregiving capacity represents the total hours available to provide services by employed caregivers. A high capacity utilization rate is a demonstration of efficient operations and schedule coordination. While 100% utilization is often unlikely, agencies should strive to have an 85% or higher utilization rate.

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❷ Total Client Hours

Total client hours is the main driver of revenue for any agency. A consistent rise in client hours demonstrates effective marketing and well-established referral networks.

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❸ Hourly Caregiving Wage

As the largest contributor to overall agency expenses, wages must be carefully managed. However it is important to also consider the impact of wages on caregiver well-being and retention.

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❹ Hourly Service Rate

As the rate offered to clients for care, a service rate for an individual client can vary based on factors like the payer source and length of shift. Diversified payer sources demonstrate an agency's versatility and resilience to sudden economic shifts.

To illustrate how these metrics play out, consider two agencies on the following page that have an average weekly caregiving capacity of 400 hours and an average caregiving service rate of $30 per hour.

Shared Attributes

$ 30 PER HOUR

400 CAREGIVER HOURS

Effect on Financial Metrics

	Big Heart Home Care	Home Helpers Care
Caregiver Utilization	75%	90%
Revenue	$468,000	$561,000
Expenses		
Staffing Costs	50% — $234,000	50% — $280,500
Marketing & Sales	6% — $28,080	10% — $56,100
Operating Expenses	30% — $140,400	25% — $140,250
Caregiver Recruitment & Retention	20% — $93,600	5% — $28,050
Total Expenses	$496, 080 — 106%	$504,900 — 90%
EBITDA	-$28,080 — -6.00%	$56,100 — 10.00%

Estimated Valuation

	Big Heart Home Care	Home Helpers Care
Estimated Value of Earnings	0	$168,300
Estimated Value of Equipment and Supplies	$20,000	$20,000

Likely Sale Price

Big Heart Home Care	Home Helpers Care
$20,000	$168,300

Big Heart Home Care is operating at 75% caregiving capacity utilization resulting in $468,000 of annual net revenue. Caregiver recruitment and retention costs are high and out of sync with marketing costs to acquire more profitable clients. At its current scale, Big Heart Home Care is losing money with EBITDA of -$20,080. Because the agency does not have positive earnings, the estimated value of earnings is $0. Therefore, a potential buyer would consider the $20,000 in equipment and supplies that Big Heart Home Care has as assets, resulting in a likely sale price of $50,000.

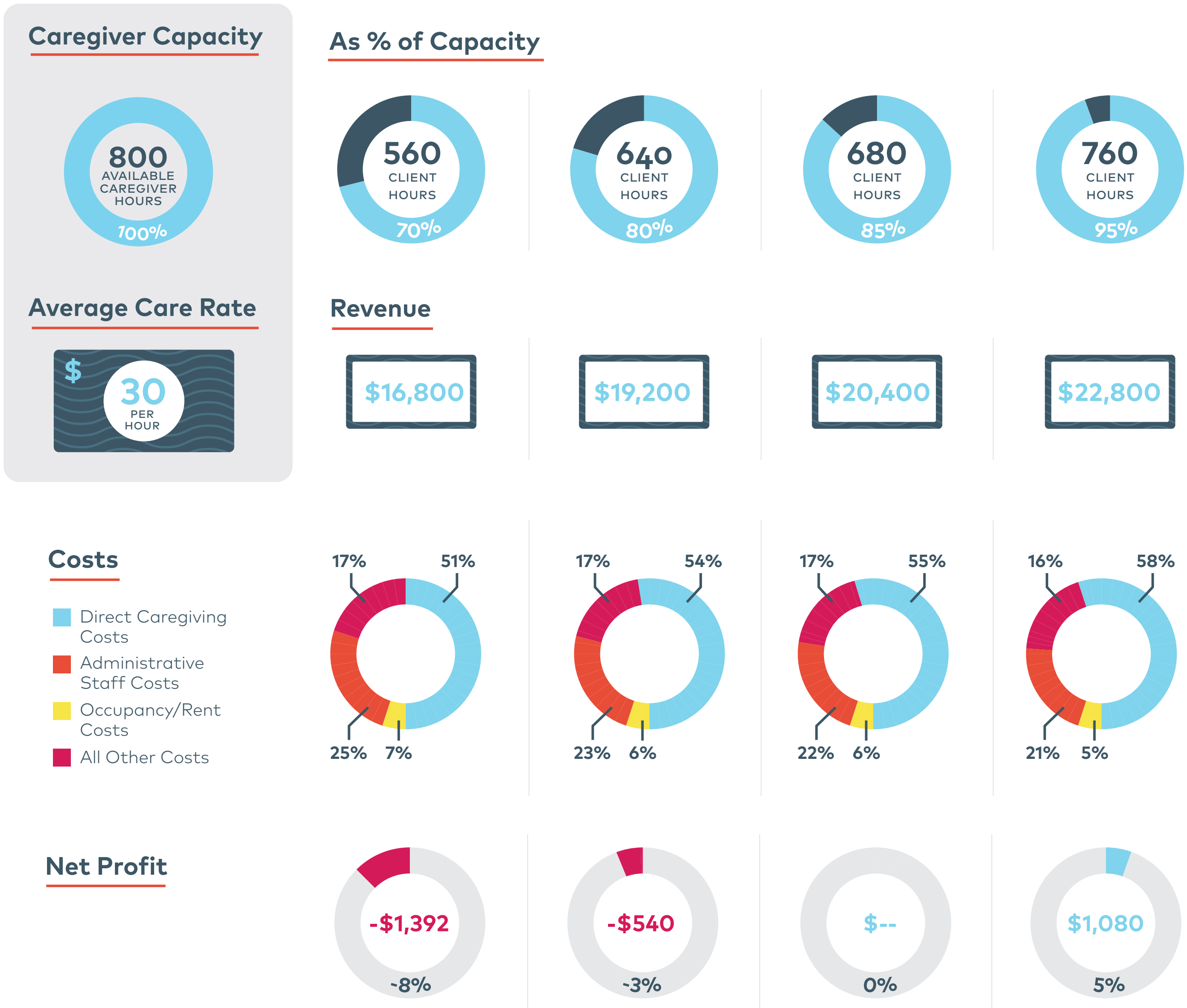
Home Helpers Care is fulfilling a 90% caregiver capacity utilization rate with $561,600 in annual net revenue. As a result of being able to effectively pair caregivers with clients, Home Helpers spends less on recruitment and is able to focus on growing their client pool. Home Helpers Care has a history of positive earnings, with a current EBIDTA of $56,160. We can apply an earnings multiple of 3 to EBIDTA to produce an estimated valuation of earnings of $168,480. This number represents a likely sale price.

Working towards higher billable client hours and caregiver capacity utilization at your agency is critical— as you increase these two factors, you also increase your profitability. More client hours brings in additional revenue, and full capacity utilization decreases attrition and allows you to efficiently utilize your fixed costs and semi-variable costs.

Fixed costs are costs that stay the same, regardless of the number of clients your agency serves, such as rent, director's salary, and cleaning services. Variable costs are costs that change with the number of clients served, such as mileage reimbursement. Some costs, such as administrative salaries, can vary by the size of the client and caregiver pool. If a single care coordinator can handle the needs and schedules of 15 clients and 25 caregivers a week, additional administrative staff will need to be added as the agency scales so as not to erode the quality of care and employment.

"Our experience indicates that agencies who actively track the balance between caregiver utilization and client hours maintain healthy operations compared to agencies managing disproportionate values of each.

Case Study: Caring Community Home Care



Caring Community Home Care has a caregiver capacity of 800 hours a month, and an average service rate of $30 per hour. At 75% caregiver utilization (560 billable client hours), the agency loses money. As caregiver utilization increases to 80% (640 client hours) and up, variable costs—such as caregiver wages and mileage—increase, but fixed costs and semi-variable costs remain the same. This is because the agency doesn't have to hire more administrative staff or rent more space to fulfill the additional hours of care. The agency is able to break even at 85% caregiver utilization, with revenues covering its costs. At 95% utilization (760 client hours), the agency is able to make a small profit. By ensuring that caregivers capacity matches available client hours, the agency is able to more effectively use the fixed resources (rent, office staff salaries) and semi-variable (administrative wages and caregiver recruitment) costs.

How ICA Can Help

ICA recognizes that as the owner of a home care agency, you've put your heart and soul into your business and the quality care it provides. Although it can be hard, we believe that planning your eventual exit from the business is one of the best things you can do to preserve the value of your business, ensure your legacy, and achieve the retirement goals you desire. Our exit planning staff will work with you to help you set exit goals and determine your financial needs for retirement. After working with us, you will receive a summary report including:

- **Business Health Check and Cost of Care Analysis**
- **Enterprise Valuation**
- **Analysis of Business Value Drivers and Tips to Maximize Value**
- **A Summary of Paths to Exit the Business**

Visit ***icagroup.org/homecare*** *to see if you qualify for grant-funded succession planning services.*

COVID-19 Disclaimer

The COVID-19 pandemic has impacted every aspect of society—this includes the price that an owner receives from the sale of their business. A business' valuation in January, 2020 is not the same valuation today. Conducting business valuations during a pandemic requires conservative assumptions about a business' future, which results in lower values. To get a fair return from the sale of a business, post-pandemic sellers will need to adjust their expectations about the sale process, structure, timeline, and price.

Owners who are not able to be patient or flexible will find that larger, better resourced, and more powerful buyers will seize the opportunity to purchase their businesses at sub-par prices.