

HomeCare

Despite Strong Headwinds, the Future Looks Bright

September 1, 2022

By Matt Caine, Managing Director, SOLIC Capital Advisors

It's no secret that the first half of 2022 brought a shift from the pandemic-fueled revenue and merger and acquisition (M&A) growth experienced in 2020 and 2021. Still, home health care in the United States—a \$55 billion industry—continues to grow annually at 4% to 5% with respect to patient volume. As we move into the latter half of 2022, it is worthwhile to assess how both the status quo, like staffing challenges and wage issues, and new developments, such as programmatic reimbursement changes from the Centers for Medicare & Medicaid Services (CMS) and market valuation shifts, will shape the industry going forward.

No Relief for Staffing

Staffing shortages, which were exacerbated by the pandemic, are expected to remain the most challenging issue in the home health industry. In an ongoing tight labor market, many homecare aides have left the industry for more competitive compensation in supply chain, warehouse and other jobs. At the same time, an increased reliance on paid caregivers is expected, and the U.S. Bureau of Labor Statistics projects openings for these positions to increase almost 37% by 2028. One driving factor is that the ratio of unpaid family members aged 45 to 64 caring for those over 80, which was seven to one in 2016, is projected to drop to four to one by 2030. To put it simply, aging Americans have fewer family members to take care of them, thus driving an ever-increasing demand for home-based care services.

What does this mean for home health providers? While admissions growth remains strong and is expanding from both COVID-related retraction and aging demographics, margin pressures persist as providers rely on the increased use of contractors and staffing companies to offset labor gaps. Elevated salary, wage and benefit costs, along with sign-on bonuses, will continue to compress margins for providers.

On a more positive note, contract labor visits and hourly rates are trending downward. Hourly rates that peaked in the \$160 range are now around \$130. In addition, some providers are seeing a slight drop in the utilization of contracted labor sources. Providers are clear-eyed in their focus on workforce optimization, looking to balance labor costs with staffing constraints. The industry demands the efficient use of nursing labor in the field and must deploy these resources in both a time-efficient and cost-effective manner. In support of these efforts, many providers are attempting to amend or renegotiate payer contracts to reflect the current labor market.

A Growing Preference for Homecare

The pandemic opened the floodgates of demand for in-home care—and its funding—as both aging and chronically ill patients look to remain at home and avoid high-cost hospitals or skilled nursing facilities. Patients who typically do not require intensive medical supervision, but have high incidence rates of chronic illnesses, are driving this trend. As the pandemic lingers and patients wish to avoid more populated settings, in-home care remains a growing preference.

Reimbursement for home health care is substantially driven by Medicare fee-for-service (FFS), and these FFS rates have cumulatively declined by 15% over the last decade as a means to drive inefficiencies out of the market. Also, Medicare Advantage (MA) plans have switched to a per-visit model to enhance efficiencies and shift the burden of quality outcomes to the provider and away from the payer. Payers are moving to narrow their networks and are driving volumes to larger, high-quality home health providers to better ensure care and outcomes, as concerns exist around smaller, undercapitalized providers.

CMS Moves Raise Flags

CMS continues to make moves that will impact the industry in the last half of the year to drive efficiencies and wring unnecessary costs out of the system. CMS's Patient Driven Groupings Model (PDGM) approach to reimbursement continues to redefine measures for efficiencies and patient care in the home health sector.

Many providers are concerned that PDGM requirements introduce an improper scope for services and interactions provided to their patient base; that is, it does not allow them to properly account for all of the activities necessary to provide comprehensive care. CMS has proposed a repricing method to determine what Medicare reimbursement would have been had PDGM not been implemented during 2020 and 2021. It believes the industry overspent and was too inefficient, and therefore further reimbursement rate reductions need to be implemented.

In June, the home health sector was rocked by the CMS proposal to cut home health rates by 4.2% net (7.6% unadjusted) for 2023—a possible \$810 million impact to the industry. This change reflects the effects of prospective permanent behavioral assumption adjustment, as well as a decrease in outlier payment. In comparison, the final rate adjustment for 2022 was a 3.2% increase. This proposed rate cut for next year reflects a significant headwind.

CMS is proposing to apply only the permanent 7.6% rate cut to the 2023 base payment rate, which could mitigate the need for a larger adjustment in future years. However, CMS is also considering additional temporary adjustments of up to \$2 billion to recoup retrospective overpayments in 2020 and 2021, further dampening the earnings outlook for home health providers. However, the general market consensus is that this large negative adjustment will not be a part of the final 2023 rate update, as the sector is leaning on Congress for both short- and longer-term relief.

Valuation & Merger Activities Respond to Market Turmoil

In the last six months, publicly traded home health providers have seen valuation multiples drop, with earnings before interest, taxes, depreciation and amortization (EBITDA) falling from the low-20s to mid-teens. As of late July, stocks of home health provider companies traded at 70% of 52-week highs, which reflects both the reimbursement headwinds in home-based care and the broader market turmoil affecting the equity capital markets. Price-earnings (P/E) ratios have also fallen from the mid-30s to a more average P/E ratio in the low to mid-20s.

Despite some of these current trends, valuations of comparable M&A transactions continue to hold steady in the mid-teens (as a multiple of EBITDA). Thirty acquisitions closed in the first quarter of 2022, up 15% year-over-year. Of note was United Healthcare's \$5.4 billion acquisition of LHC Group, announced in March 2022, which followed the lines of Humana's hallmark \$8.3 billion acquisition of Kindred at Home in August 2021.

Important to the overall industry trends, private equity continues to deploy capital into the home health sector, seeking to grow market share, enhance realization of economies of scale and enter new markets. Cases in point include Wellspring Capital Management's purchase of Caring Brands International, LLR Partners' purchase of

Affinity Hospice and Webster Equity Partners' purchase of Honor Health Network. All of these were executed in the fourth quarter of 2021, and the trend is expected to continue.

Volumes associated with Medicare Advantage plans are a major driver of large acquisitions as these plans are building large market concentrations. Access to clinicians and wage inflation will also continue to drive consolidation. In these scenarios, acquirers of home health operations are looking for referral sources, any concentrations with larger health systems, a robust payer mix, and secondary and tertiary market players, as large primary markets are inundated with competing providers. Small providers, which make up 75% of the home health market, are especially looking for situations that help them better respond to or leverage reimbursement changes, COVID-related issues, labor costs and the continuous move to digitalization.

Home Health's Future Remains Robust

Despite some bumps in the current environment from staffing, CMS reimbursement changes and fluctuating valuation, the growing demand for home health services—undergirded by the undeniable demographics in this country—is paving the way for strong market drivers for home health.

Based on a survey of physicians who serve predominantly Medicare FFS and MA patients, McKinsey & Company estimates that up to \$265 billion worth of care services for Medicare FFS and MA beneficiaries (which accounts for up to 25% of the total cost of care) could shift from traditional facilities to home-based care by 2025. The company also notes how this shift can be a win-win for benefit payers, health care facilities and physician groups, home health providers, technology companies and investors alike, as well as patients. Home health is set for strong growth going forward.



Matt Caine is a Managing Director with SOLIC Capital Advisors, where he provides financial advisory services, including investment banking and capital restructuring support, to taxable and tax-exempt facilities-based providers, such as home health and hospice organizations, life plan communities, skilled nursing providers, independent and assisted living facilities, regional health systems, community hospitals, ambulatory surgery centers, and multispecialty physician practices. Mr. Caine is a Chartered Financial Analyst (CFA), a Certified Insolvency & Restructuring Advisor (CIRA), and holds a Certification in Distressed Business Valuation (CDBV).

###