Crimson Cardinal
Healthcare Intermediary

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Managing Adult Care Facility Financial and Operational Ratios to Maximize Enterprise Value

Small adult care and family care operators can maximize enterprise value by creating strong, sustainable discretionary earnings. Enhancing brand equity, enriching payor mix, and managing expenses drives long-term profitability and above-average operational excellence. In this article, we examine those key metrics operators can focus on to enhance enterprise value.

Revenue

Revenue Trends

Revenue trends tell a lot about the health of an operation. Increasing revenue indicates a healthy business environment especially if the revenue growth is from rising rates or new revenue sources such as auxiliary services.

Brand Equity and Referral Trend

Are your new patients from referral sources or from your advertising efforts? A strong referral network implies that you have a strong, positive brand in the marketplace. If you need to advertise to get new patients, it can be costly. One can expect new facilities to make considerable investment in advertising when developing their brand. Older, established facilities should be able to rely on their existing reputation to attract new patients. If this is not the case, that may indicate that a quality problem exists.

Payor Mix

Enhancing the payor mix means attracting more private pay patients rather than Medicaid patients. In NC, on average, the monthly private pay rate is $3,800 compare to the NC Medicaid rate of $2,345.

Patient Mix

Memory care patients require more personal care than typical adult care patients. In the NC private market, the average fee for memory care is $950 per month more than standard adult care.

Operating Ratios

Occupancy Rate

Unfilled beds are one of the biggest hidden costs to an adult care operation. Each month a bed goes unfilled is revenue you cannot get back. A facility needs to always operate in the 90% to 95% occupancy rate to remain financially viability. Vacancy is especially dangerous for small operators. In NC, regulations limit family care operations to a maximum census of 6. Leave two beds unfilled can drop revenue by one-third. Also, it is not easy expanding your patient population as a family care operator in NC. Most facilities are in residential area and may be controlled by a homeowners' association. These association cannot restrict you operating a family care home, but they may restrict such expansions. Expanding beyond 6 beds requires an adult care license which, in NC, is governed by certificate of needs regulations. Alternatively, an operator may acquire or open another family care home. This option, however, raises additional fixed costs and may compound the vacancy problem. So, for most small operators, keeping occupancy very high may be to only viable option for sustaining healthy revenue.

Fixed Costs

Rent. Many small adult care operators own their facilities. They usually create a pass-through entity that owns the real estate and rents it back to their operating companies. The proper measure of rent, however, is the market rate for the space, not what the operator pays the pass-through entity in rent. In markets like the Research Triangle Park (NC) where rental rates have outpaced the inflation rate, there is a strategic advantage to owning your facility. If a small adult care operator leases her space, she faces the risk that her rental rate could substantially increase at the end of her lease period. If you lease your space, consider negotiating options to buy your space when renewing your lease.

Variable Costs

Wages (Semi-Variable). Wages is one of the most important expenses to manage. It can range as much as 40% of operating costs in small adult care operations. Is your staff long-term or temporary help? Are you understaffed and, as a result, paying overtime pay? Are the employee benefits you provide consistent with industry practices? Do you use independent contractors? If so, are you certain that they would not be classified as employee under the State's employment laws? Have you reviewed your employees' classifications under current labor laws? Non-exempt employees are entitled to overtime pay and other benefits bestowed by labor laws.

Food Costs

Meal planning and smart buying techniques can materially reduce food costs. Do you have a licensed dietician or nutritionist on-staff or available for consultation? Are you a member of any grocery purchasing clubs or associations? Do you buy in bulk periodically or purchase food items as the need arises?

Utilities

Compare how your facility performs to similar operations. Your local utility companies can provide statistics on the energy efficiency of your building. Is the building property insulated? Excess draft can significantly increase utility costs during severe weather. Do you have your heating, ventilation, and air conditioning systems checked annually?

Unexpected Repairs

Unexpected repairs can drain your operating cash. Have you consider joining a home warranty program such as American Home Shield? Do you have a handyman available at reasonable rates?

Profitability and Discretionary Earnings

The results of growing your patient roll, enriching your payor mix, and managing your operating expenses will yield substantial improvements in your operation's profit and discretionary earnings. Ideally, your operation should yield year-over-year profit and discretionary earnings increases of 15% to 25% per year over a minimum of 3 to 4 years. As your operation reaches capacity, your profit margins (i.e., profit divided by revenue) should be at their peak and holding steadily.

Liquidity and Debt Service Coverage

Liquidity is the life blood for your operation. Without it, you cannot timely pay your bills or staff even if your operation is profitable. Ideally, you want to maintain at least 3 months of cash to cover rent, utilities, payroll, and food costs. If you have bank or seller loans, periodically review your debt service coverage. Your operating cash flow (i.e., pre-tax profit plus non-cash expenses like depreciation and amortization) should cover at least 2X the current portion of your bank and seller loan for the same period. A strong debt service coverage ratio shows potential buyers that the operation can support outside financing.