

# NAHC 29th Annual Meeting and Exposition

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*Financial Statements 101: Preparation and Analysis of  
Financial Statements for Mergers and Acquisitions  
Decision Making*

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# Overview

- Comparative Analysis
- Financial Statements
- Application

# Why is this important?

- Professional Management
- Comparative Analysis
- Valuation, Underwriting, etc...

# Apples to Apples Analysis

- GAAP – Generally Accepted Accounting Principles
- Cash or Accrual Basis of Accounting
- For Maximum Clarity and Credibility

# Cash Basis of Accounting

- Greatest strength - simple!
- Report income when received
- Report expenses when paid
- Greatest weakness – can be very misleading!

# Accrual Basis of Accounting

- More accurately reflects revenue and expenses for home health agencies by matching revenue and related costs

# Cash vs. Accrual Example

- Claims and Collections
  - RAPs billed and collected in January - \$1000
  - Final claims billed and collected in March
  - Days in Episodes
    - 16 days in January
    - 28 days in February
    - 16 days in March

# Cash vs. Accrual Example

- Payroll
  - January: \$250 earned, paid 2/15
  - February: \$500 earned
    - \$250 paid 2/28
    - \$250 paid 3/15
  - March: \$250 earned, paid 3/31

# Cash vs. Accrual Example

- Supplies
  - Ordered and received in January
  - \$500 bill received in February
  - \$500 paid 3/10
- Supplies Used
  - January: \$50
  - February: \$100
  - March: \$250

# Cash Basis Example

	January	February	March	Total
Revenue	\$1,000	\$-0-	\$668	\$1,668
Direct costs				
Payroll		\$(500)	\$(500)	\$(1,000)
Supplies			\$(200)	\$(200)
Net income	\$1,000	\$(500)	\$(32)	\$468

# Accrual Basis Example

	January	February	March	Total
Revenue	\$445	\$778	\$445	\$1,668
Direct costs				
Payroll	\$(250)	\$(500)	\$(250)	(1,000)
Supplies	\$(50)	\$(100)	\$(50)	\$(200)
Net income	\$145	\$178	\$145	\$468

# Key Financial Statements

- Balance Sheet
- Statement of cash flows
- Statement of owners' equity
- Operating Statement (P&L)

# Key Financial Statements

- Sources of Financial Data
- Range of Financial Statements

# Balance Sheet

- Accounts receivable
- Supplies Inventory
- Accounts payable
- Accrued expenses

# Balance Sheet

- Enterprise Value is Not Book Value
- Snapshot of Financial Condition
- Strength or Weakness of Negotiating Position
- Working Capital

# Why P&L?

- EBITDA
- Size, Trends, Margins
- Business Mix, Geography, Management Depth

# P&L: Top Line to Bottom Line

- The Top Line
- Above and Below the Line
- The Bottom Line

# Operating Statement

- Revenue/costs by payer
- Revenue/costs by service line
- Direct cost ratio to revenue
- Direct costs by discipline
- Administrative expenses
- Actual versus budget

# Revenue Recognition

- When Cash Received
- When Revenue is Earned
  - When visits performed (non-episodic)
  - Evenly over 60-day episode

# M&A Considerations

- Reliable Revenue
- Business Mix
- Trend

# P&L: Above and Below the Line

- Gross Profit
- Revenue – Direct Expenses
- Buyer Valuation Model

# P&L: Above and Below the Line

- Above the Line – costs directly related to Patient Care
  - Employee/Contract Labor
  - Mileage
  - Benefits
  - Medical Supplies

# P&L: Above and Below the Line

- Below the Line - Costs not directly related to Patient Care
  - Administrative salaries
  - Mileage
  - Benefits
  - Rent

# P&L: The Bottom Line

- $\text{Revs-Direct}=\text{GP}$
- $\text{GP-Admin}=\text{Net Income}$
- EBITDA
- Adjusted EBITDA

# Adjusted EBITDA

- Pro Forma, not Projection
- Positive Adjustments
- Negative Adjustments

# Who Will Use the Financials?

- Bankers
- Vendors
- Investors
- Credit agencies
- CMS
- Most important – YOU

# Conclusions

- Financial Analysis Necessary to Ensure that Margin Supports Mission
- GAAP/Accrual Necessary for Comparable Analysis
- P&L/EBITDA
- Must Be In Context