Preparing an Effective Exit Strategy in an Evolving Industry

A Guide for "Mom and Pop", Owner-Operators, of Seniors Housing & Care Properties

By: Humair Sabir

Over the past few years, I have spent a lot of time in the field working with "mom and pop" sellers, delivering my sales pitch on why I think they should sell their properties to my firm. Getting to know them, hearing their experiences, and understanding their motivations has helped me to develop a better understanding of how our industry works on a basic level.

In my experience, mom and pop owner-operators tend to be very entrepreneurial, strong-willed, and passionate. These traits come from the fact that most owners, with their families, have developed their properties from the ground-up and have worked extremely hard to build a successful business over many years. Further, mom and pop owners are very compassionate, nurturing, and caring, which are some of the essential qualities required to be a quality operator in the healthcare industry. Needless to say, they have a very strong emotional attachment to their properties, not just because they consider it their "baby", but also for the services that it provides to their respective communities and the jobs that it creates for their staff.

Based on these factors, it is easy to see why selling a seniors housing & care business is an extremely emotional and sensitive decision. Unfortunately, I have seen too many mom and pop owner-operators struggling to get the most value out of their life long investments.

From my transactional experience in this industry, I have compiled a handful of suggested steps and some common hazards for the mom and pop owner-operators to avoid as you develop and execute your exit strategy:

i. **Hire only advisors that specialize in the industry.** Healthcare is a very unique, large and evolving industry. There are numerous sub-sectors within the industry that are even more unique and have become their own industries for all intents and purposes. For example, seniors housing is considered to be its own sector and it is very common for attorneys or brokers that work in the seniors housing industry to have never worked in other healthcare sectors. In addition, it is important to hire brokers, consultants, accountants, or attorneys that are industry veterans within your sub-sector so that they understand the intricacies of your business.

   I am always perplexed when I still see a listing of a healthcare facility by a general residential or commercial real estate broker. Not selecting experienced advisors in your sector can cause you to miss out on reaching your target audience. This lack of experience may garner you a less competitive sale price, which means you are leaving money on the table for your valuable business.

ii. **Stay tuned to trends in the industry.** Whether you are an assisted living, independent living, or skilled nursing owner-operator, it is important for you to keep track of macro trends within your sector and determine how they may impact you. Even if these trends don't directly impact you in your market, it is key that you have an understanding of the overall market and environment as this will help you to determine the best time to exit.

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iii. **Take the time to plan and calculate.** While this may seem like a very obvious point, I'm always surprised by the lack of time spent by sellers in evaluating their decision to sell. Many owner-operators have told me that they decided to sell when they ran into a broker who convinced them that selling their property was the right thing to do. This, in my opinion, is a clear conflict of interest, and you should ensure that <u>you</u> are really the one making the final decision for <u>your</u> interest.

   Although timing the market is extremely important, it is equally as important to know what you are trying to accomplish. As you plan for your exit strategy, spend some time thinking about why you are looking to exit and ask questions like:

   Am I looking to retire completely to focus on other things? Do I still enjoy operating the business? Do I want to be actively or passively involved after the sale? What will happen to the residents, patients, or staff members when I leave? Is my current business too challenging for me?

   The most important question, in my opinion, is whether you think you still have a competitive advantage in this environment and whether you expect that advantage to continue. Answers to these questions will factor into the next few points on this list.

iv. **Prepare quality financial statements.** This goes back to the first point on this list about hiring qualified accountants that understand the industry. Buyers are going to value your facility based on the cash flow it generates, which will be a huge focus during the sales process. I have been given financials that are squeaky clean and I have also seen financials that were hand written on a piece of paper. Nothing sets off red flags for buyers more than a set of financials that are poorly prepared. The quality of the financials are usually an indicator of the sophistication of an operator and it's important to use this to your advantage by making a strong impression.

v. **Consider all options before making the decision to fully exit the business.** Unless you are looking to retire outright for health or other reasons, there may be other options available to you to consider. For example, if you enjoy operating but want to take some money off the table, you may consider a sale-leaseback or sale-manageback scenario. Alternatively, you may choose to stay involved in only the real estate as a landlord and lease the facility to another operator in exchange for a steady and stable cash flow. This topic will be the focus of another publication, in which I will further the point alongside some real world examples and case studies based on my recent transactional work.

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vi. **Before you select an offer, make sure to take into consideration the fact that healthcare transactions are complex and time consuming.** Healthcare transactions involve receiving regulatory approvals from government agencies, which adds uncertainty to the equation. Most seniors housing transactions, in my experience, can take three-to-six months to close from the time a definitive agreement is executed. There are a lot of macro environment changes that can happen within that time period (e.g. reimbursement cuts, overall economic struggles, etc.) and in the micro environment (e.g. operational issues, poor regulatory survey, etc.). It is important to be working with an experienced buyer that understands the complexities of operating in the healthcare space so they can patiently work with you throughout the process, especially if there are road-bumps along the way.

vii. **Beware of notorious "re-traders".** It can be extremely exciting to receive an "off-the-charts" offer during the marketing process. Temptation to accept such an offer is understandably high. An outlier offer is risky and can be a sign of a buyer who has not properly underwritten the deal and is just motivated to tie up the sale and figure out the details later. This is where researching the background of the bidding firm and the reputation of the buyer plays a key role. A qualified, experienced, industry-focused broker can be valuable in this regard and can guide you in the right direction on which offer to select. Since most brokers are compensated entirely at closings, they're highly motivated to steer you in the direction that offers certainty of execution.

To be clear, not all firms that have had "re-trades" in the past are bad actors. In fact, sometimes a re-trade shows willingness and flexibility on the part of a buyer to maneuver through challenges that may arise during the various stages of a transaction. In many cases, a seller is very willing to take a lower price instead of allowing the buyer to completely walk away from the deal. This is especially true if the new information has come to light during the due diligence phase which was materially misreported (intentionally or unintentionally) in the marketing phase, in which case it should not create a negative perception of the buyer.

viii. **Execute on your plan by keeping your eye on the ball.** Having a signed letter of intent, or a purchase and sale contract, is hardly a guarantee that your deal will close. Most deals are priced on recent financial performance and it's important to maintain that performance through closing. Contracts in our industry generally have a generous due diligence period and contain termination rights for the buyer, with very little or no penalty. Therefore, it is critical that you maintain oversight of the facility and maintain its current standing with regards to operations and financial performance to ensure a smooth closing and also preserve the value of the property in case the buyer is unable to close on the deal.

ix. **Involve staff only on a strict need-to-know basis.** Rumors about a potential sale can spread quickly and can cause panic within your staff. This can have a devastating impact on your operations as workers tend to head towards the exits when they believe new management is going to be taking over the facility. Therefore, you should only involve staff members that you trust in a strict confidential manner so that you won't have to play damage-control later. A simple way to disguise the activity and visits to your facility is to tell the staff that this is all related to insurance or refinancing of the property. Also, you should inquire about the buyer's due diligence process upfront, so as to not disrupt your staff and operations at a later point.

In conclusion, take a step back and reflect on whether you still maintain a competitive advantage in this industry. Once you have made your decision to sell, prepare a well thought-out exit plan, and execute it effectively by leveraging quality, industry specific advisors.

The author, Humair Sabir, currently serves as Vice President of Acquisitions at Granite Investment Group. He has been involved in reviewing and closing billions of dollars in seniors housing and skilled nursing transactions. For any comments, inquiries, or questions, please call 949.477.5800 or email hsabir@graniteinvestment.com.