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THE SeniorCare Investor

Inside the World of Senior Care Mergers, Acquisitions and Finance Since 1948

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In This Issue

The skilled nursing M&A market has been hot, with many buyers chasing the few facilities on the market. That has caused prices to rise to astonishing levels in some cases.

One deal sticks out as both an outlier and part of the trend: the sale of Stonerise Healthcare in West Virginia. Here, we dive into the deal, which we believe set a record for per-bed price in the sector.

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Stonerise Sale Stands Out in Hot SNF Market

Lument Advises on Highest-Priced SNF Deal on Record

We keep thinking we've seen the pinnacle of skilled nursing valuations, but prices keep surpassing our expectations. We are surprised because we count significantly more headwinds than tailwinds facing the industry. But many who see things differently have jostled for whatever SNFs are up for grabs: old or new, stabilized or...not.

One deal in particular stands on its own and fits the trend of buyer frenzies and lofty values. That was the sale of **Stonerise Healthcare** in West Virginia, expertly handled by Managing Director Laca Wong-Hammond and Associate Director Dominic Porretta of **Lument Securities**.

Founded in 2009 by Larry Pack and Steve White, the Morgantown-based provider has steadily grown through acquisitions over the years. Stonerise acquired nine skilled nursing facilities in 2015 to reach 15 facilities, followed by two single-SNF acquisitions in 2017 and 2018, respectively, to bring its portfolio to the current 17 facilities and 1,955 beds. West Virginia has not issued a new skilled nursing facility license in the last 25 years, so after cobbling together 90 beds from its other facilities or purchases, Stonerise is also developing a new all-private unit SNF in Summersville as well.

Stonerise also built its home health and hospice business de novo to include seven agencies serving 45 of the 55 counties in West Virginia and a part of southeastern Ohio. The ancillary businesses also include a therapy company and an institutional special needs plan (I-SNP). However, we can surmise that a majority of Stonerise's revenues came from the skilled nursing facilities.

These facilities were an impressive operation. First, to their quality, they had received significant capex over the years from Stonerise, including many gut renovations, meaning they showed great with an average effective age of around 12 years. That is quite new for the skilled nursing sector.

Second, the state: with no new licenses issued this century in West Virginia, the relative scarcity of beds dramatically increases the appeal of a company with the size and in-state concentration (plus ancillary services) as Stonerise. That also contributed to occupancy surpassing 90% across the portfolio, which rebounded from a short-term, pandemic-era drop that was commonplace across the industry. West Virginia also reportedly has some of the highest Medicaid rates in the country, so with a healthy quality mix of nearly 30% for the first five months of 2022 annualized, operating margins exceeded 20% across the SNF portfolio, which even beats pre-pandemic levels. That is a rare feat these days. What's remarkable is that the performance could be even improved through case mix index add-ons and stayed strong despite agency staffing usage and wage increases to retain staff.

So, Stonerise was a well-oiled operation with scale in a great reimbursement state where all but one deal in the past four years has been valued well above $100,000 per bed, according to our statistics. But, the founders wished to pursue other ventures both professionally and personally. They also recognized the timing of the market as advantageous for a sale. Were they reading *The SeniorCare Investor*? Because we would have to agree. So, did they make the right call and get a premium on their company sale?

All signs point to... absolutely yes. Starting with the purchase price, which was not disclosed, there are a few clues to an approximate value for Stonerise. We tried to get pricing information from Lument, but they would not disclose anything beyond what was in the press release. However, based on the facts that were disclosed and talking to market participants, we have made some assumptions to derive an approximate price.

We know that $582 million of debt was secured by the buyers to finance the deal, which included both bank and non-bank financing. White Oak Healthcare Partners, the HUD affiliate of White Oak Healthcare Finance, placed $100 million of junior capital through its proprietary program with CareTrust REIT (NYSE: CTRE), which included a $75 million "C" piece at an 8.4% interest rate and a $25 million mezzanine loan at 11%. There was also $482 million of "A" and "B" debt provided by bank and finance company syndicates, with multiple participants.

With that type of capital stack, we could estimate coverage rose above 90% of the purchase price for assumption purposes. In addition, the skilled nursing facility portion of the business can support a higher leverage than the ancillary businesses, and we estimated around 90% of Stonerise's value could be apportioned to the SNFs. However, other sources of financing may not have been revealed, so the actual amount of capital arranged to fund the deal could be even higher.

With those assumptions in place, we would estimate the price for the company at around $650 million, or above $615 million for the skilled nursing portion. With around 1,955 beds, including the 90 beds under development, the per-bed price comes out to around $315,000, which we believe may still be a conservative estimate given that's on licensed beds, not operational, which is usually a key transaction metric.

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If that is the case, it would be the highest per-bed price for skilled nursing we have ever recorded, according to our LevinPro LTC statistics. But this was not a fluke, as a very competitive bidding process saw multiple suitors submit similar offers around that high value. But the sellers were not going to just go with the highest bid, as company culture and guarantees of employee retention were top of mind for Stonerise's founders. To have such a successful operation, you need talented and dedicated staff, so any successful buyer would have to (and want to) meet those demands. And we heard that the buyer did rehire everyone, which is good.

Supposedly, the buyer pool consisted of a mix of private equity firms and REITs, and a New York-based private real estate investment firm was selected with an operating partner, CommuniCare Health Services, which we imagine also put some skin (equity) in the game. We suspected a couple of companies as the buyer, since their description, headquarters, past investment history and existing relationships matched the descriptors provided. One company in the mix was Eagle Arc Partners, which has made major SNF purchases in recent memory. However, combing through public documents revealed that Next Healthcare Capital was the buyer, in addition to CommuniCare.

Based in New York, Next has made similar acquisitions in the past, including a $152 million ($150,000 per bed) acquisition of nine Virginia SNFs in December 2020, a $204 million ($95,000 per bed) purchase of 15 SNFs in Pennsylvania in 2019, and the acquisition of 12 facilities in Florida and New Hampshire in 2018 for $134 million, or $101,000 per bed. According to its strategy, Next acquires "high-quality, well-performing skilled nursing facilities and portfolios with long-term value." That checks out for this deal. Also stated on their website, "we form personal relationships, and understand the financial goals and the overall needs of a family business" would have sounded appealing to the sellers.

Returning to the portfolio's valuation, we would assume the cap rate was significantly below historical norms for the skilled nursing sector of 12% to 13%, which have fallen closer to 11% in the post-pandemic seller's market. Applying a 100-200 basis point premium (lowering the cap rate) to the 2022 *Senior Care Acquisition Report*'s national median SNF cap rate of 10.7%, especially given the per bed prices we suspect, an 8.7% to 9.7% cap rate on the skilled nursing portfolio (and our estimated $615 million purchase price) would result in approximately $53.5 to $59.7 million of trailing EBITDA. We don't see levels like that often, but this was a unique portfolio by all accounts including some of the country's best Medicaid rates, and performance had even exceeded pre-pandemic levels. If the facilities operated above a 20% margin, skilled nursing revenues likely ranged from $265 to $300 million, resulting in a price-to-revenue multiple of 2 to 2.3x, maybe higher.

Certainly, the Stonerise sale stands out among all the rest, with its geographic concentration, relatively young age, high quality facilities and ancillary businesses, but the hyperactive bidding process and aggressive valuations have become almost standard in the industry in the last six to 12 months. Interest rates have risen and squeezed the spreads of other real estate sectors like seniors housing or multifamily, leading investors in search of yield to the SNF business, where cap rates have traditionally stuck between 12% and 13% in good economic times and bad.

At the same time, there were not enough sellers in late 2021 to early 2022 to meet that investor demand, since many were still getting through the pandemic, waiting for census to rise to get a better value or receiving bountiful government aid. Too little supply and too much demand led to bidding wars and prices to rise to higher levels. We were not alone in saying some prices were way too high, with some working on SNF deals telling us they were flat-out shocked by the final prices they got for their clients. One experienced broker told us of a skilled nursing deal in which multiple bidders submitted offers for 20% and 25% higher than their highest expectation. And these were older facilities without much positive cash flow.

A market price is a market price (and makes for very happy clients for those brokers and bankers), but we just could not understand acquiring at such a high basis considering the higher debt service payments that would entail. Expenses could keep rising (especially for labor), occupancy could stay stagnant, and CMS announced that PDPM-related rate adjustments will be coming, making covering a facility's debt that much more difficult. At least state coffers are currently full to cover Medicaid payments and patients will need post-acute care in a recession or not. But the headwinds highlight the fact that skilled nursing is a risky business (hence the higher cap rate), and risk needs to be priced into those assets. And we don't want to hear of excessive cost cutting from these investors (some of whom are or will be mistaken for PE in the media) to achieve their desired returns.

The average price per bed rose 23% from $79,700 in 2020 to $98,000 in 2021, only $1,200 per bed lower than the record-high set in 2016 at $99,200 per bed. And in the first half of 2022, 50% of disclosed prices announced surpassed $100,000 per bed, with several topping $200,000 per bed and one (Stonerise) nearly reaching $300,000 per bed. But this has not been a phenomenon of only the highest quality facilities. Rather, according to our statistics, from 2020 to 2021, per-bed prices rose 50% for facilities aged 40 years or more, 36% for facilities built between 20 and 40 years ago, and 27% for the newest facilities opened in the last 20 years. Yes, those oldest facilities started at a lower basis, but buyers nonetheless paid more for them despite their age.

We will soon release the updated rolling-four quarter statistics on the skilled nursing and seniors housing markets with Q1:22 and Q2:22 information, so the continued rise of SNF prices should be confirmed.

Our next question is, how long will this continue? But also, would higher interest rates and a recession reduce the number of buyers on the hunt for facilities, or would it drive more investors out of lower-yielding seniors housing to SNFs? Will owners jump off the sidelines to sell their facilities while values are still so high, leading to a potential decline in the average price? We hope to know the answers to these questions by our September 2022 webinar on the SNF M&A market, but if there are any other confused souls out there, give us a call. Or for those who disagree, change our mind!


WE HELP YOU
REALIZE YOUR VISION.
When the owners of Stonerise Healthcare, West Virginia's leading skilled nursing and transitional care provider, decided to sell their closely held businesses, they turned to Lument. Lument's M&A* team created tax-advantaged exit structures, leveraged its buyer relationships, and delivered exceptional results.
"Meeting our objectives for confidentiality and ongoing stability while providing a solution for our ancillary businesses required superior execution. Lument delivered."
Larry Pack, Co-Founder and CEO
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