ACUVANCE | Coker®

Healthcare Financial Due Diligence

From Earnings Validation to Actionable Transaction Strategy

By Brendan Cash, CPA



About the **Author**



Brendan Cash

CPA
Vice President

(216) 513-8047
bcash@cokergroup.com

Brendan Cash is a Vice President at Acuvance Coker and leads the firm's Quality of Earnings and Financial Due Diligence practice. He brings more than nine years of experience in healthcare transaction advisory and external audit, supporting private equity sponsors and investment banks on buy-side and sell-side transactions. His experience spans behavioral health, physician practice management, dental services, home health, and healthcare technology. Brendan focuses on Quality of Earnings, revenue analysis, working capital, and provider compensation, bringing an investor-oriented perspective to risk identification and value creation across the transaction lifecycle.

Contents

About the Author 2

Executive Summary 4

Why Traditional Financial Reviews Fall Short in Healthcare 5

Quality of Earnings as a Valuation & Risk Tool 6

Integrating Operational Expertise into Financial Diligence 7

Turning Diligence Insights into Transaction Strategy 8

Conclusion 9

Executive Summary

In healthcare transactions, valuation is rarely determined by topline growth alone. It is determined by confidence—confidence that reported earnings are sustainable, that cash flow will convert as expected, and that operational realities support the investment thesis. In a market defined by reimbursement pressure, regulatory scrutiny, and labor volatility, that confidence must be earned through rigorous, healthcare-specific financial diligence.

Traditional financial reviews often confirm historical performance without fully explaining whether those results can persist under institutional ownership. In healthcare, earnings are shaped by payer dynamics, provider compensation models, revenue cycle execution, and operational capacity constraints. Without understanding these drivers, even a technically accurate Quality of Earnings (QoE) analysis may fall short of supporting defensible valuation decisions.

This paper outlines a structured framework for healthcare financial due diligence that integrates three critical components:

- **Quality of Earnings (QoE)** to normalize EBITDA and isolate sustainable earnings
- **Quality of Revenue (QoR)** to assess revenue durability, payer mix stability, and reimbursement risk
- **Net Working Capital (NWC)** analysis to protect liquidity and reduce closing friction

When combined with operational insight, these analyses move beyond confirmatory diligence and become strategic tools. They inform valuation ranges, strengthen underwriting assumptions, shape deal structure, and identify post-close priorities before capital is committed.

For private equity sponsors, this approach enhances underwriting precision and reduces downside exposure. For investment bankers, it supports a credible and defensible valuation narrative that withstands buyer scrutiny. For founder-owners, it ensures that the business is evaluated based on its true economic engine rather than distorted by accounting presentation or misunderstood operational decisions.

In healthcare, financial diligence is no longer a box to check—it is the analytical foundation of transaction success. The ability to translate diligence insights into actionable strategy is what separates strong transactions from merely completed ones.

Why Traditional Financial Reviews Fall Short in Healthcare

Traditional financial reviews often confirm historical performance without fully explaining whether those results can persist under institutional ownership. In healthcare, earnings do not exist in isolation from operations. They are shaped by payer contracts, billing practices, provider compensation models, staffing decisions, patient mix shifts, and working capital mechanics. Without understanding these drivers, even technically accurate financial analyses may fall short of supporting defensible valuation decisions.

Standard diligence approaches—trend analyses, historical financial statement reviews, and EBITDA normalization—can be directionally helpful. However, healthcare economics rarely live neatly within GAAP alone. Value is embedded in operational execution and reimbursement behavior. A financial review that lacks healthcare-specific insight may validate reported results but fail to illuminate the sustainability of those earnings.

To assess value properly, healthcare financial diligence must integrate three core components:

- **Quality of Earnings (QoE)** to isolate sustainable earnings
- **Quality of Revenue (QoR)** to evaluate revenue stability and reimbursement exposure
- **Net Working Capital (NWC)** analysis to protect liquidity and closing mechanics

When combined, these analyses provide a more complete picture of risk, durability, and long-term value.



Quality of Earnings as a Valuation & Risk Tool

At its core, valuation is an assessment of future cash flows and the risk associated with achieving them. A robust Quality of Earnings analysis provides direct insight into both.

In healthcare, reported EBITDA often masks underlying volatility. Payer dynamics, billing and coding practices, provider compensation structures, and timing differences between revenue recognition and cash collection can distort economic performance. A rigorous QoE analysis normalizes non-recurring items, identifies embedded inefficiencies, and separates accounting presentation from economic reality.

For private equity sponsors, this clarity informs leverage capacity, debt sizing, and return modeling, while reducing the likelihood of post-close earnings headwinds. For investment bankers, a credible sell-side QoE anchors valuation discussions around a defensible adjusted EBITDA, minimizing retrades and preserving competitive tension. For founder-owners, it ensures the business is evaluated on its true earnings power rather than conservative accounting practices or misunderstood line items.

Beyond valuation, QoE plays a central role in risk mitigation. Healthcare businesses operate at the intersection of clinical delivery, reimbursement frameworks, and compliance obligations. Risks often reside in areas traditional diligence does not thoroughly examine—revenue recognition policies that lag operational reality, payer concentrations that expose cash flows to rate changes, or provider compensation models that compress margins as scale increases.

When paired with a robust **Quality of Revenue (QoR)** analysis, diligence moves beyond “how much” a business earns to “how and why” revenue is generated. QoR evaluates payer mix stability, contractual rate visibility, denial and collection trends, and exposure to reimbursement pressure. Identifying these risks pre-transaction allows them to be appropriately priced, structured around, or mitigated before capital is deployed.



Integrating Operational Expertise into Financial Diligence

In healthcare, earnings are not abstract financial outcomes; they are the direct result of operational execution across clinical delivery, revenue cycle performance, payer interactions, and provider economics.

Traditional QoE analyses often prioritize technical accuracy over operational context. Financial trends are reconciled and EBITDA is normalized, yet the operational forces behind those numbers remain insufficiently examined. In healthcare, this disconnect introduces risk.

Revenue growth cannot be fully understood without evaluating patient volumes, provider utilization, and access constraints. Margin stability may obscure misaligned compensation structures or labor inefficiencies. Strong collection metrics can mask payer concentration exposure or reimbursement compression. These are not accounting nuances; they are operational realities with direct implications for valuation and risk profiles.

An integrated approach translates operational insight into earnings sustainability:



Revenue is analyzed alongside patient mix, payer dynamics, and clinical capacity



Labor and provider costs are normalized using realistic productivity and compensation models based on market standards



Margin variability is assessed in light of reimbursement structures and execution discipline



One-time adjustments are evaluated to determine whether they reflect anomalies or recurring operational challenges

Rather than adjusting EBITDA in isolation, this approach explains whether earnings can persist and grow under institutional ownership.

For sponsors, this enhances underwriting precision and reduces downside exposure. For bankers, it strengthens valuation narratives and withstands buyer scrutiny. For founders, it ensures that economic value is accurately represented and defensible.

Turning Diligence Insights into Transaction Strategy

Financial diligence creates value only when its insights are translated into action. The difference between a successful healthcare transaction and a missed opportunity is rarely the identification of issues; it is how those issues inform structure, negotiation, and post-close execution.

Too often, diligence findings are treated as static conclusions. Adjusted EBITDA is finalized, working capital targets are set, and the process advances. In healthcare—where earnings are shaped by reimbursement behavior, provider incentives, and operational capacity—insights that are not operationalized lose much of their strategic value.

When properly leveraged, diligence directly informs:



Valuation ranges



Downside protection



Deal structure, including earnouts, escrows, and indemnities



Financing assumptions and lender comfort



Post-close operating priorities and integration sequencing

Revenue risks identified through QoR analysis may shape valuation sensitivity or payer-focused diligence. Earnings normalization tied to provider compensation structures may influence incentive redesign post-close. Working capital analysis may determine closing mechanics that protect liquidity from day one.

When surfaced early and embedded into strategy, these insights enable proactive decision-making rather than reactive problem-solving. Transactions become more predictable, negotiations more focused, and outcomes more durable.

An additional, often overlooked benefit is alignment. When buyers, sellers, bankers, and lenders are grounded in the same economic reality, friction decreases and momentum improves. Clear articulation of earnings sustainability reduces valuation disputes. Transparent revenue analysis builds credibility. Data-driven working capital frameworks prevent last-minute surprises.

In healthcare, where complexity is the norm and margins for error are narrow, this alignment is a competitive advantage.

Conclusion

Healthcare transactions demand more than financial confirmation. They require a clear understanding of how earnings are generated, how revenue behaves under pressure, and how operational realities influence future performance. In a sector defined by reimbursement complexity, provider dynamics, and regulatory exposure, surface-level financial reviews are rarely sufficient.

A well-executed healthcare financial due diligence process integrates Quality of Earnings, Quality of Revenue, and Net Working Capital analysis with operational insight. It clarifies valuation assumptions, identifies risks before they become costly surprises, and ensures that capital is deployed with precision. When diligence is performed through this integrated lens, it becomes more than a reporting exercise—it becomes a strategic advantage.

For investors, it strengthens underwriting and protects returns. For bankers, it preserves credibility and momentum through closing. For founders and operators, it ensures that value is articulated, defended, and realized based on economic substance rather than accounting presentation.

In today's healthcare M&A environment, the margin for error is narrow and the cost of misalignment is high. Transactions succeed not simply because issues are identified, but because insights are translated into structure, execution, and post-close strategy. Financial diligence, when properly applied, provides the foundation for that alignment.

The ability to convert analysis into action ultimately distinguishes durable transactions from fragile ones. In healthcare, that distinction is not optional—it is indispensable.





ACUVANCE | Coker®

For further information about Acuvance Coker,
and how we could be of assistance, please contact:

(800) 345-5829

askcoker@cokergroup.com

visit acuvancecoker.com