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The leader in Health Care Services Mergers & Acquisitions

INSIGHT INTO HEALTH CARE SERVICES MERGERS & ACQUISITIONS

THE BRAFF REPORT.

Why Staffing Could be the Next Big Thing in Health Care M&A

An Investment – and Divestiture – Thesis

It's what private equity is constantly on the lookout for.

The convergence of events in the not-so-distant future that can produce extraordinary growth in a specific sector. Get in a bit ahead of the inevitable rise in valuations, and you have the makings of a consolidation play that can produce extraordinary returns.

They call it an investment thesis.

We call it Health Care Staffing.

Let's break it down.

The cycle is right.

Ask anyone who's been around health care staffing for 20 or so years and they'll tell you that the fortunes of health care staffing move in cycles. It's not entirely clear why. Some have postulated that hospitals go through waves of doing everything they can to avoid the cost of temporary staffing. And when care is inevitably compromised – and revenues are lost because they can't find the full-time staff they require – they come back to staffing with pent-up demand.

Regardless, it is remarkably predictable.

Let's look at the last 20 years of health care staffing M&A drawn from proprietary data collected and analyzed by The Braff Group.

Talk about cycles. Between 2001 and 2020, we can see two distinct cycles. More importantly from an investment perspective, we are currently in a low period. So, if past is prologue, it's not without reason to anticipate the start of an upswing beginning in 2021.

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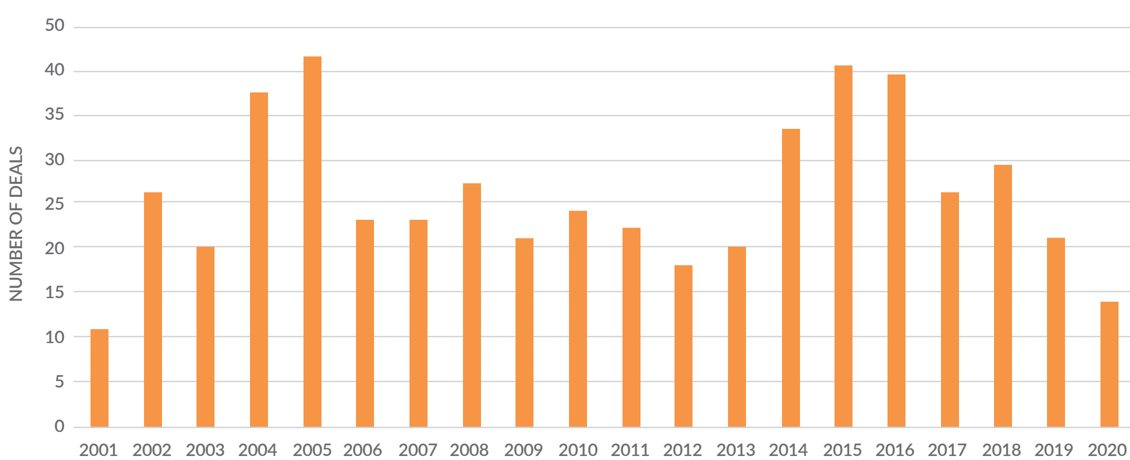
Health Care Staffing Deal Trends



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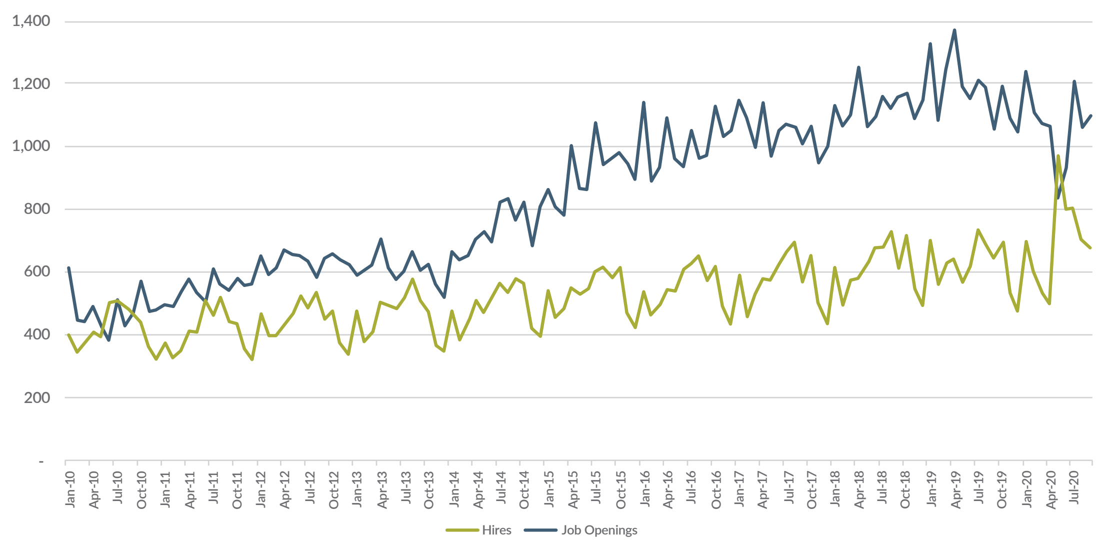
Even before COVID, the demand for staffing was rising.

Based upon data from the Bureau of Labor Statistics on health care job openings vs. new hires, between 2010 and the onset of the pandemic in the spring of 2020 (which created a temporary distortion), the gap in unfilled positions has grown substantially. Moreover, even before the pandemic hit, this gap was expected to widen. In fact, in 2018, Research and Markets predicted that the global "shortage of healthcare staff and rise in demand of healthcare services are expected to propel market growth with a CAGR of 5.4% from 2017 to 2025."[1]

Gap in Health Care Job Openings and Hires



Expectations for post-pandemic demand.

Forget the statistics for a moment and consider the state of health care today. While new vaccines are expected to eventually arrest the spread of COVID, the United States is amidst runaway growth of new cases and deaths. So, the strain on healthcare professionals, which in some regions has only abated briefly, is crushing.

In a study cited in an article published by the Forbes Technology Council entitled, "Nurses Are Stressed to the Verge of Quitting — It's Time to Implement Technology to Help," the writer states,

"[COVID] stressors have manifested themselves as a 'perfect storm' of stress for nurses around the world, and the results are sobering. According to one recent study surveying over 1,200 health care workers in China, nearly half of the health care respondents who treated COVID-19 patients now have anxiety and depression, and a third struggle with insomnia."[2]

We can imagine that many providers are gritting their way through it out of dedication to their patients and co-workers.

But what might we anticipate around the third quarter of 2021, when much of the US is expected to have been inoculated from the virus? Would it be unreasonable to expect that legions of overworked, stressed-out healthcare workers will, at a minimum, need to take an extended leave, or even retire once they no longer feel the professional obligation to remain?

But wait, there's more.

[As a result of COVID], would it be unreasonable to expect that legions of overworked, stressed-out healthcare workers will, at a minimum, need to take an extended leave, or even retire once they no longer feel the professional obligation to remain?

[1] Research and Markets: "Healthcare Staffing Market Analysis By Service (Travel Nurse, Per Diem Nurse, Locum Tenens, Allied Healthcare), By Region (North America, Europe, Asia Pacific, Latin America, MEA), And Segment Forecasts, 2014 - 2025"

[2] Forbes Technology Council: Nurses Are Stressed to the Verge of Quitting — It's Time to Implement Technology to Help; August 26, 2020.

There is a substantial backlog of surgeries.

While hospital ICUs have been overrun by COVID patients, the postponement of elective procedures has created a substantial backlog in surgeries which has a profound impact on both a hospital's financial performance and staffing needs. According to estimates by the American Hospital Association cited in an excellent analysis from McKinsey & Company entitled, "Cutting Through the COVID-19 Surgical Backlog,"[3]

"The financial impact of this reduction in elective procedure volume, which typically drives a disproportionate share of revenue and margin for hospitals, caused an estimated $200 billion in financial losses for hospitals and health systems between March and June 2020, before accounting for relief funds."

To work through two months of excess surgical demand in less than one year, it would require hospitals across the country, on average, to operate at 120 percent of historical volumes for ten straight months.

Moreover, McKinsey estimates that

"…There may be two months or more of excess surgical demand across the United States by the end of 2020. For the United States to work through two months of excess surgical demand in less than one year, it would require hospitals across the country, on average, to operate at 120 percent of historical volumes for ten straight months."

So, as we emerge from the dark shadow of COVID, there will be substantial opportunity – and pressure – to perform these surgeries.

But there's a catch (there's always a catch) which brings us full circle to our investment thesis.

In surveying 25 hospital systems in July of 2020, the most often cited challenge to ramping up elective surgery capacity is, yup, you guessed it, workforce shortages.

With unprecedented demand for staffing, will there be enough supply?

This is the riddle of the Sphinx when it comes to health care staffing. High demand is great. But useless if you can't fill the open positions. It's a good bet that post COVID, with the backlog of surgeries coming at the very same time many caregivers will need a hiatus, spots will undoubtedly go unfilled. But will there be enough supply to fuel out-sized growth for a sustained period? We think so. Here's why.

- Previously fearful of COVID, many would-be health care workers will return to the temporary workforce.
- The extraordinary demand coupled with the financial incentives hospitals have to perform elective surgeries will likely support higher prices, which, in turn, will lure even more providers to fill temporary positions. The money may simply be too good to pass up.
- Numerous articles have been published stating that caregivers on the front line throughout the pandemic will likely suffer some form of PTSD. So, when they return to work, they may very well prefer temporary rather than permanent positions to have the flexibility to work when they want, and back off when they need to.

So, let's summarize.

When [COVID weary health care providers] return to work, they may very well prefer temporary rather than permanent positions to have the flexibility to work when they want, and back off when they need to.

The investment – and divestiture – thesis for health care staffing:

- The cycle is right.
- Demand for health care staffing was rising before the pandemic.
- As a result of COVID, demand is even greater.
- With elective procedures postponed, there will be a backlog of post-pandemic surgeries.

[3] McKinsey & Company: "Cutting Through the COVID-19 Surgical Backlog," October 2, 2020.

- This, in turn, will support even greater demand for staffing long after the pandemic slows.
- Since hospitals have substantial financial incentives to perform these surgeries, the conditions may support higher pricing.
- The pool of temporary providers will swell as COVID-fearing would-be caregivers return to the market and exhausted providers eschew full-time work for temporary positions.
- Revenues, margins and valuations spike and are sustainable.

Watch this space.

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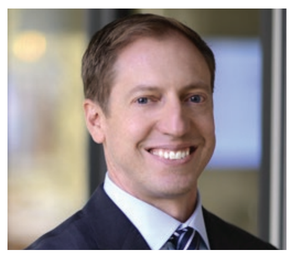

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