A Banner Year for Mergers & Acquisitions

Health Care Staffing M&A Year in Review

Last year when we published “Why Staffing Could be The Next Big Thing in Health Care M&A,” we laid out a thesis as to why we expected 2021 to be a breakout year.

In summary, we wrote:

- The cycle was right.
- Demand for health care staffing was rising before the pandemic.
- As a result of COVID, demand would be even greater.
- With elective procedures postponed, there would be a backlog of post-pandemic surgeries.
- This, in turn, would support even greater demand for staffing long after the pandemic slows.
- Since hospitals have substantial financial incentives to perform these surgeries, the conditions might support higher pricing.
- The pool of temporary providers would 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 would spike and would be sustainable. Well, breakout it did, and the numbers are eye-popping.

Based upon proprietary data collected and analyzed by The Braff Group, staffing deal volume was up 236% vs. 2020 and 15% greater than the previous record of 41 deals set way back in 2005.

Private equity investment in the space was also up substantially, equaling the previous high-water mark of 24 total transactions reached in 2016. Of note, however, was the mix of PE vs. non-PE (strategics and others) sponsored transactions.
HEAT MAPS

As the charts illustrate, across all the health care service sectors we cover, PE’s portion of deal flow has risen steadily since 2012, now accounting for nearly 60% of all transactions in the space. In staffing, however, the comparative mix has ebbed and flowed. So, while total deals sponsored by PE rose dramatically in 2021, as a percentage of all deals completed, since peaking in 2017, PE’s comparative interest has slid.

What gives?

Unlike publicly traded or independent players that have been in the space for a long time, PE is far more risk averse when it comes to staffing. This was always the case due to the cyclical nature of the sector, especially given holding periods of 5-7 years which could catch the downside of one of those cycles. But now, with COVID-spiked rates, hours, and demand, PE is particularly – and arguably overly – wary.

Don’t misunderstand. They want in. But they are skittish, to say the least, when it comes to valuation. More on this later.

How does staffing stack up against other health care service sectors?

From the five-year view, it is evident that behavioral health and home health and hospice has dominated health care services M&A, with health care staffing lagging. But the picture looks a lot different when we take a two-year look back. While it’s problematic to rely heavily on a short time frame, with such strong fundamentals girding the space, staffing’s breakout in 2021 is almost assuredly the start of a longer-term trend.
THE VALUATION CHALLENGE

The biggest challenge in health care staffing mergers and acquisitions is valuation. Demand has risen to unprecedented levels, and with it, so have bill-rates. As a result, agencies are racking up triple-digit growth in revenues and earnings. But buyers wonder – or more accurately agonize over – how long it will last. Quite natural – and appropriate. But sometimes we see a disconnect between a reasonable assessment of risk and a reasonable assessment of the underlying market conditions.

Consider demand.

As the charts below indicate, the gap between job openings and hires has been growing steadily since 2014. When staffing transaction volume hit its previous peak between 2015-2016, the deficit was 600,000 positions. It now stands at double that amount.
It's been well documented that because of COVID, postponement of elective surgeries has created a significant backlog. In an excellent report by McKinsey and Company¹, researchers estimated that by the end of 2020, the backlog would be about two months. With the Delta and Omicron surges over the past 6 months, we'd guess that the current estimate would be no different, if not higher. Now, two months doesn't sound that bad, until you consider McKinsey's estimates of how long it would take to clear such a backlog. As the chart suggests, even if the volume of procedures rose to 110% of historical volume, it would take almost two years (20 months) to get back to even. And with the current staffing shortage, it's hard to imagine that hospitals will be performing at 110% for quite some time (if ever). In essence, then, the staffing shortages of today are creating the staffing demands of tomorrow.

And then there's the labor unrest that portends strike activity as pre-COVID collective bargaining agreements expire.

Considering all this, it's probably a safe bet that the spike in hours that staffing firms have logged over the past 12-18 months is not going to fall off anytime soon.

INSIGHT INTO HEALTH CARE SERVICES MERGERS & ACQUISITIONS

How about rates?

According to Prolucent Health², a workforce data and technology company, over the past 12 months advertised pay rates for travel nurses jumped 67%. No doubt this has contributed mightily to staffing providers’ increase in revenues and profits. But here’s the thing. A quick look at historical gross profit figures for publicly traded health care staffing companies AMN Healthcare Services and Cross Country Healthcare show that despite their substantial growth, gross profit margins are the same (AMN) or down a percentage point (Cross Country) compared to historical averages. This means that the rate hikes are being passed down proportionately to the providers. Now, with signing bonuses averaging about $15k³ and soaring to $20-30k⁴ in some areas, it seems apparent that the caregivers are calling the shots in terms of wage requirements.

So, with demand exploding – and burnout exploding even more – should we expect these wage levels to fall anytime soon? Not likely. Then why would we expect bill rates to tumble, and tumble fast? Well, we wouldn’t (or perhaps, shouldn’t).

Despite all this, when valuing health care staffing companies, many buyers – particularly PE sponsors as mentioned above – are modeling substantial reductions in placements and rates as if they were going to happen immediately, and risk adjusting multiples downward. Accordingly, much like we saw in residential addiction treatment, where buyers way overestimated their exposure to a rapid contraction of out-of-network billing premiums, we believe that many would-be buyers are misreading the “real” risk attendant to health care staffing, and in many cases, creating unbridgeable gaps in valuation between them and even the soberest of would-be sellers. Notably, such gaps should be addressable by including contingent payments based on future numbers. However, while protecting their downside, we’re seeing more than just a few buyers reluctant to give up the seller’s fair share of the upside.

Now to be clear, we are not suggesting that such extraordinarily favorable conditions are devoid of risk. Many question whether they’re sustainable purely from an economic point of view; where are hospitals and other institutions supposed to get the money to pay for it all? Then there’s allegations of price-gouging which recently prompted a letter signed by 195 House members calling for a White House probe to investigate such claims. So, there is risk. Not unlike, we might add, the “strike-of-the-pen” risk any health care provider deriving substantial reimbursement from Medicare or Medicaid routinely faces. It’s the magnitude that is in question.

OUTLOOK

Valuation complexities notwithstanding, we fully expect M&A activity in health care staffing to remain robust over the next 12-36 months. The market dynamics are simply too compelling – and alluring. The one hitch on the horizon? Whenever we see a rapid rise in deal flow in a niche market like staffing, the pool of potential acquisition candidates that are ready to sell can diminish quickly. As a result, at some point we could see a temporary lull in activity.

Watch this space.

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The Braff Group is the leading mergers and acquisitions advisory firm specializing exclusively in health care services, including behavioral health, home health, home care, and hospice, home medical equipment, pharmacy services, staffing services, urgent care, digital health and ancillary services. The firm provides an array of sell-side only transaction advisory services including representation, debt and equity recapitalization, strategic planning, and valuation. Founded in 1998, The Braff Group has completed more than 370 transactions. According to Refinitiv, The Braff Group has repeatedly been ranked among the top 5 health care mergers & acquisitions advisory firms.

- Behavioral Health
- Home Medical Equipment
- Urgent Care
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- Staffing Services
- Digital Health
- Pharmacy Services
- Ancillary Services