After an extraordinary 2021 in which overall health care services and home health and hospice mergers & acquisitions eclipsed their all-time records by 30.1% and 26.1% respectively, the natural question heading into 2022 was whether the pace could be sustained. Not surprisingly, based upon proprietary data collected and analyzed by The Braff Group, it would appear not. As illustrated below, if we annualize data from the first quarter of 2022, aggregate health care services and home health and hospice deal flow contracted 16.1% and 31.8% respectively.
But – and there’s a big but here – there’s a lot of noise in these numbers:

1. With sellers wanting to dodge the possibility of a doubling of capital gains tax in 2022 (which thus far has not occurred), many accelerated their exits to 2021, thereby inflating the annual tally.

2. Due, in part, to inflationary pressures, the market was spooked as GDP declined 1.5% in Q1 2022 after a 6.9% increase the previous quarter.

3. The unrest in Ukraine has created uncertainty amongst investors regarding the global impact on the economy.

As a result, we see similar trends across the entire M&A market.

Consider the chart below which compares quarterly deal flow for health care services to private equity sponsored transactions across all industries.

While the quarterly fall-off in Q1 2022 for health care services was 19.4%, the contraction across all PE deals was a whopping 30.3%. The differential is not entirely surprising as over time, under declining economic conditions, health care tends to outperform other sectors as investors perceive its characteristic inelastic demand as being less risky.

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**Segment Specific Results**

**Home Health and Hospice**

In analyzing the specific segments within the sector, perhaps most noteworthy is what we are currently seeing in certified home health and hospice.

Consider the following charts:
We have long held that from an M&A perspective, home health and hospice tend to move in opposite directions. Because many providers offer both services, transaction volume tends to be a zero-sum game. So, any investor preference in one segment often comes at the expense of the other.

When the home health Patient Driven Grouping Models (PDGM) were announced in 2019 and implemented in 2020-2021, the go-forward uncertainty drew buyers away from Medicare certified providers and toward hospice, which reached record highs in both volume and valuation. But by the middle of 2021, the second phase of PDGM was well understood. And with increased confidence in certified home health, buyers began to return to the segment – in droves. Moreover, after such a steep run-up in hospice acquisition demand, not only did the pool of potential acquisition candidates begin to drain, but from a buyer’s valuation perspective, home health became comparatively more affordable. Moreover, demonstration projects that began in 2021 that “carve-in” hospice into Medicare managed care have ticked up the segment’s risk profile.

As such, thus far in 2022, home health continues to perform at the record levels it set in 2021, while hospice deal flow, at least for now, has slowed.
Interestingly, it’s easier to explain the no activity in Medicaid than the small number of deals in private duty.

With only +/- 12 transactions completed per year in the Medicaid space over the past six years, it would not be unusual to see a quarter go by with one or no deals.

But after a record-tying year of 50 transactions in 2021, the six private duty deals recorded in Q1 2022 seem unusually low. That said, much like we surmise may be a factor in hospice deal flow, it is possible that after such a run-up in volume, the supply of candidates may be down.

Moreover, on both the Medicaid and private duty fronts, buyers may be exhibiting some caution as staffing challenges begin to chip away at visits, hours, and revenues.

Medicaid and Private Duty

In examining Medicaid and private duty transaction data for the first quarter of 2022, we’re not sure whether we’re seeing unexpected developments, or merely an anomaly.

As the charts illustrate, there was a dearth of activity in both segments.
OUTLOOK

On a macroeconomic level, we do have concern regarding interest rate hikes as the Fed tries to curb inflation.

Prior to March of this year, the last time the Federal Reserve Board increased its interest rate was in December of 2018. But in March, it raised rates by 25 basis points. Two months later, it bumped up rates an additional 50 basis points, the largest increase in 22 years. And as of this writing, speculation is that the Fed is poised to pile on another 75 points.

As rate hikes trickle down through all facets of the banking system, we can anticipate increases in interest rates for senior and subordinated debt, which, on average, accounts for about 50% of the currency private equity relies upon to finance its deals. Accordingly, to realize targeted internal rates of return, any curb on the amount of more costly debt they’re willing to deploy will likely curb valuations as well.

And with PE arguably largely responsible for the historic multiples we’ve seen over the past 12-18 months, we may see somewhat more disciplined valuations ripple through the entire M&A market.

On a micro level, we remain bullish on home health and hospice M&A.

After Optum’s announced $5.4 billion acquisition of LHC Group, and the pending spin-off of the home health and hospice operations of Encompass Health (which will likely free up value currently encumbered by the legacy Health South business), the sentiment towards Medicare certified home health and hospice remains extremely positive. As well it should be as these services continue to be seen as a critical component of many population health/capitated payment models.

Similarly, despite the slow start in Medicaid and private duty M&A, we anticipate these segments will continue to fare well.

The above notwithstanding, after a 2021 juiced by tax avoidance strategies (see above) and a higher interest rate environment in 2022, we would have to be cock-eyed optimists (emphasis on the cock-eyed) to not anticipate some fall-off in deal volume – and perhaps some pressure on valuation.

In short, a strong year for home health and hospice M&A, if not a record breaking one.
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20 YEARS & COUNTING

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.

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