After an extraordinary 2021 that topped the previous record for private equity deal volume across all industries by more than 50%¹,², and propelled health care staffing deal volume to a level 22% greater than its previous high-water mark reached in 2005, expectations were that we would see a falloff in activity in 2022.

The big question was how much?

Especially considering the macroeconomic storm clouds forming:

1. **Tax rate incentive disappears.** Some of the surge in transaction volume in 2021 was driven by fears that the special tax treatment for capital gains would be eliminated effective 2022, which would essentially double the tax rate on proceeds from a sale. In the end, it didn’t happen. Nevertheless, as we entered the year, not only did this incentive disappear, but the pool of acquisition candidates was also almost assuredly diminished as would-be 2022 sellers (and beyond) advanced their exit timeline.

2. **Inflation marches on.** According to Forbes, “inflation began to spike in the U.S. in April of 2021, when it hit 4.2% [and] continued to climb, hitting 7.0% year-over-year by December 2021.” By June of 2022, “the rate peaked at 9.1%.”³ And with it, costs increased, especially wages, exerting pressure on EBITDA margins.

3. **Cost of debt rises.** The playbook for reining in inflation calls for increasing the Federal Funds rate, which increases the cost of debt and chips away at valuation. And so it went. In March, the Fed dipped its toe in the increased rate waters with a modest bump of 25 basis points. In May, it upped it another 50, and by June, the Fed increased rates yet again by 75 points. By the end of the year, the Federal Funds rate had risen from a range of 0.25 - 0.50 to 4.25 – 4.50, a 400 basis point increase in total. As a result, PitchBook reports that since the first quarter of 2021, the average yield for leveraged buyout loans has doubled from around 5% to plus/minus 10%.

4. **Russia invades Ukraine.** In M&A, there’s nothing like uncertainty to turn a hot market instantly cold. And there’s nothing like the breakout of war in eastern Europe – and all the geopolitical and economic consequences it can create – to spook buyers and provide the incentive to hide their cash in the proverbial mattress.

So, with all these factors converging that could directly or indirectly negatively impact acquisition demand, supply, financing, and pricing, you could be forgiven for expecting the volume of deals completed in 2022 to plunge faster than Bitcoin.

But it didn’t.

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² Since PE investment drives a substantial portion of health care staffing M&A, we look to PE trends as a good barometer of what we may anticipate in the sector.
At the macro market level, private equity deal volume barely moved, down only 2% vs. 2021.

What did fall, however, was the average size per transaction. As the accompanying chart shows, from the 2nd quarter of 2021, average deal size fell steadily from $159M to $99M in Q4 2022, a falloff of 38% from its peak.

The upshot? PE still wanted to do deals. They just wanted to hedge their bets a bit and target smaller transactions, including follow-on deals.
Health Care Staffing

As we entered 2022, perhaps the biggest unknown was how a reduction in the number and severity of COVID cases might reduce demand and pay rates. While demand and rates have fallen, it is perhaps most instructive to compare where we are today compared to where we were pre-pandemic.

Staffing Demand

As we wrote last year in “The Braff Report: How to Value a Health Care Staffing Company,”

“When (a) COVID likely to stick around in some form or another for the foreseeable future, (b) stalwart caregivers ready to bolt once they see a sustained lull in new cases, and (c) a backlog of elective surgeries that McKinsey and Company estimate could take as long as 20 months to work through, you’d have to be quite an optimist to think this crisis can be resolved any time soon.”

And the data would seem to confirm this.

Perhaps the best gauge of demand for health care staffing is the data published by the Bureau of Labor Statistics that tracks the number of health care and social assistance job openings vs. hires, and notably, the gap between them.

As the charts below clearly show, the impact of the pandemic is still very much with us today, with the number of unfilled positions still ranging between 1,000,000 to 1,400,000 – more than double pre-pandemic levels.

Staffing Rates

As it relates to rates, in the same publication, we wrote, “What about bill and pay rates? Will they contract quickly? Well, not if you believe in those pesky laws of economics that say when demand outstrips supply, prices rise. And then there’s the human aspect to consider. It’s easy to raise wages. But cut them? Quickly? When COVID has dramatically shifted the work/life balance decidedly towards life? Well, you get the picture.”

So, not surprising, while rates have fallen, it appears that they still remain well above pre-pandemic levels.

As illustrated in the chart below, although the figures have moved around a bit, according to Vivian Health, average travel nurse weekly pay for the three months ended October 2022 was still 54% greater than the three months prior to COVID.
The above notwithstanding, demand, pay rates, and hospital policies regarding utilization are not only highly localized, but they can also change rapidly as conditions on the ground -- not the least of which is provider morale -- ebb and flow. So, while the sustained shortages suggest that, over the long run, health care staffing companies will continue to prosper, the cycles that have characterized the sector in the past will also remain, albeit perhaps at higher levels, and for shorter durations. Stay tuned.

Market Impact

With demand and bill rates still high, interest in health care staffing more than offset the broad market headwinds. In fact, as illustrated below, after a breakout year for nearly all health care service sectors, staffing was one of only two sectors that recorded increases in deal flow in 2021.
We can get a better understanding of how health care staffing stacks up against other health care service sectors by looking at a “heat map” developed by The Braff Group. While the sector has not produced as many deals over the past five years, it is one of the fastest growing areas of health care services mergers and acquisitions, second only to behavioral health care.

As illustrated below, the raw numbers provide an even more compelling illustration of how health care staffing M&A has soared. Rarely do we see such an immediate and dramatic shift in deal activity.

* The Braff Group has developed “Heat Maps” to better contrast M&A activity across varying sectors and segments. Along the vertical axis is the total number of transactions completed over the past five years. Along the horizontal axis is the slope of the trend line over that period. Taken together then, the higher and further to the right a sector is, the greater – and more robust - the acquisition interest in that sector, both in terms of volume and growth.
Private Equity

And lastly, we examine PE activity in health care staffing as they are often harbingers of deal volume in the future as other PE firms are drawn to the sector, and those already with platforms seek follow-on deals. And as illustrated in the chart below, both have happened in a big way as 2022 produced a record number of market-entry platform and follow-on transactions.

We can also see that PE’s share of staffing transactions increased substantially, rising from 48% in 2021 to 67% in 2022.
Outlook and Valuation

Even if demand, utilization, and pay rates soften, the shortage of health care providers is almost assuredly going to remain above – and perhaps well above – pre-pandemic levels (that at the time, were considered extremely alarming). Accordingly, the fundamental reasons buyers have aggressively targeted health care staffing over the past two plus years remain solidly in place.

But, and there’s that pesky “but” that’s like a cold splash of water in the face, there are several unresolved legacy and emerging issues that can have a meaningful impact on the future of health care staffing deal activity and valuation.

Determination of EBITDA

The determination of the “right” EBITDA against which a valuation is applied remains the most significant legacy issue clouding health care staffing M&A. Despite credible – and predictable – evidence that elevated demand and pricing is likely to remain in place for the foreseeable future, buyers are still struggling with determining an acquisition candidate’s sustainable, go-forward revenue and earnings.

The good news is that most are willing to consider purchase price adjustments based on hours and pay rates. The less good news, however, is that in constructing two-tier payouts, we see buyers aggressively protecting their downside (by essentially reverting to pre-COVID performance levels for pricing tier one), but fashioning tier two in such a way that they capture more of the upside than is arguably due them, often leaving sellers short.

As the shortages in health care providers and elevated pay rates, as illustrated above, continue to outlive the pandemic (as a reasoned assessment of real-world market dynamics and the laws of supply and demand suggests), gaps in anticipated performance and pricing should begin to narrow.

Reduction in Supply of Acquisition Candidates

As we have seen repeatedly across many sector consolidation cycles, after a steep run-up in transaction volume – as we have seen in health care staffing – the pool of acquisition candidates ready for sale often falls. Accordingly, while not at all a referendum on the attractiveness of the space, we may very well see a leveling off – or even a drop – in activity in 2023 as the pipeline of potential deals becomes replenished.

Competition from the Tech Platforms

Over the past 24 months or so, a substantial amount of venture capital has been invested in tech platforms designed to match providers with open positions deploying a dynamic rate structure that flexes based upon what is necessary to fill an open position. The bet is that a seamless platform that offers a best-in-class user experience will capture share currently held by more traditional firms. While many large staffing companies are developing and deploying their own tech models, the investment community believes such platforms may be transformative – and disruptive. This remains to be seen. But it could be a threat that redistributes both revenues and acquisition demand.

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“The determination of the ‘right’ EBITDA against which a valuation is applied remains the most significant legacy issue clouding health care staffing M&A.”

“While not at all a referendum on the attractiveness of the space, we may very well see a leveling off – or even a drop – in [health care staffing] activity in 2023 as the pipeline of potential deals becomes replenished.”
The Multiples

We know, you’re probably thinking “finally!”

As we pointed out in great detail above, the determination of representative EBITDA is arguably equally – or perhaps more – important than the multiple in determining the value of a health care staffing company in the current market. Still, for planning purposes, there are ranges that can serve as a good starting point for prospective buyers and sellers.

First, it is important to note that over time, multiples of asset light, health care service businesses that are directly, or indirectly, exposed to reimbursement risk tend to coalesce around 5x EBITDA. So, as illustrated in the accompanying chart, all the segments of health care staffing are enjoying elevated valuations.

The hierarchy of value remains unchanged with multiples rising as we move from largely cost per diem and travel to often revenue generating allied and locums positions.

The above notwithstanding, it can’t be stated enough that these are broad ranges that in no way account for the unique trends or risk profile characteristics that, when unfavorable, can knock them down, or when favorable, in a strategically orchestrated auction environment, can boost them substantially.

All things considered, then, despite a few unknowns that dog the space, the outlook for health care staffing M&A over the next 12-24 months remains bright.

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