In this Voices article, Behavioral Health Business sits down with Dexter Braff, President of The Braff Group, to discuss one of the first topics that come up in behavioral health mergers and acquisitions processes — purchase price multiples. From both the buyer and seller perspective, he explains what multiples are, the components that go into them, and how they are calculated. He also provides insight into the key considerations providers should have if they are contemplating a sale.

Editor’s note: This interview has been edited for length and clarity.

The Braff Group is a mergers and acquisitions advisory firm specializing exclusively in health care services including behavioral health, home health, home care and hospice, health care staffing services, home medical equipment, pharmacy services and ancillary health care services. To learn more, visit thebraffgroup.com.

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**Q: Behavioral Health Business:**
In behavioral health mergers and acquisitions, the first topic that usually comes up is multiples. What is a multiple and what components go into it?

**Dexter Braff:** Conceptually, a multiple is an industry and company-specific factor which, when applied to a measure of earnings—typically earnings before interest, taxes, depreciation and amortization (EBITDA)—provides a quick way to assess the value of a business. All valuation is basically derived from three primary items: income, risk and growth. When you put these three things together, you come up with an imputed value that represents the cash purchase price of a business payable at close, with the exception of perhaps some holdbacks for unknown liabilities.

**Q: Behavioral Health Business:**
How is a multiple calculated?

**Dexter Braff:** Technically speaking, the formula for determining a multiple is $1 \div (r-g)$, where “r” is the rate of return required by an investor to invest in an opportunity with equivalent risk, and “g” is long-term perpetual growth.

That said, if you ask 100 buyers and sellers if this is how they calculate a multiple, at best, you’ll get a few, “kind of, sort of”, but for many, you’ll get a blank stare. And therein lies the problem. Everyone talks about multiples, but they’re rarely used, or calculated, the way that they’re intended. Therefore, the application of multiples in valuation is very loose at best.

**Q: Behavioral Health Business:**
Do buyers rigorously calculate company-specific multiples?

**Dexter Braff:** In practice, buyers rarely, if ever, calculate company-specific multiples. I think private equity sometimes gets close to it as part of an alternative method of valuation called “discounted cash flow,” but less so as a standalone metric.
Braff: Well, it’s not nearly as scientific as one might suspect. You see, at any given moment in the lifecycle of a consolidation period, a kind of conventional wisdom emerges regarding what companies are being sold for at that time. For example, at the peak of the market in 2021, people were saying that the starting multiple for a behavioral health care company was eight to ten times earnings.

Essentially, those numbers were born of two primary drivers. The first comes from where a sector stands in relationship to health care services as a whole. So, if over time, asset-light health care service companies subject to third-party reimbursement risk typically sell for five to six times earnings (as they do), given the rapid increase in behavioral health care services demand, utilization, funding and long-term growth, multiples would be expected to rise above this base level.

Secondly, in vibrant M&A markets, there is much discussion from buyers, sellers and other industry insiders about the valuation comps that they have heard other companies being sold for. The key is that virtually no one really knows if those comps are accurate, or where they even came from, but at any given moment, such comps in combination with the then comparative assessment of the attractiveness of a sector morphs to become a generally accepted range of value — a range of value that can become self-confirming over time.

Then, bearing this range in mind, buyers and sellers adjust that multiple up or down based on some evaluation of whether a company is more or less risky (the “r” from the technical calculation) or is growing faster, or slower (the “g” from the technical calculation) than an average provider.

So if the base range is eight to ten and the buyer thinks, “Oh, this company is riskier than a typical company, or is not growing,” they might move to a 7.5 x. Is there any rigorous math behind that? Almost never. It’s all based on impression and a subjective evaluation of where a company fits relative to what a buyer or seller thinks a typical company in their sector should be selling for at that time.
Q: Behavioral Health Business: 
When a multiple is applied to determine a valuation, what does the buyer get, and what liabilities, if any, are assumed?

Braff: Sellers hear multiples all the time, but they rarely know what buyers are expecting for these valuations. Based on the way that multiples are supposed to be developed, a buyer is entitled to two primary items — all the operating assets of the company, and the adequate working capital necessary to operate and sustain the business at its near-term projected level. Notably, working capital includes the buyer’s assumption of non-interest-bearing working capital liabilities.

Those operating assets also include intangible assets, which, in health care, are often the most important ones. Referral source relationships, the technical and clinical expertise of the personnel, the assembled workforce, the reputation, the management and sales infrastructure — those are intangible assets. They may not sit on a balance sheet, but they are the assets that drive sustained revenue, profitability, and ultimately, value.

Typically, the buyer does not assume interest-bearing debt, but if they do, that assumption is part of the overall value. So, a buyer can buy a business and say, “I’ll give you $10,000,000 in cash for the business, or I’ll give you $8,000,000, and I’ll assume $2,000,000 of your interest-bearing debt,” that would be the same valuation.

Q: Behavioral Health Business: 
What is the biggest problem in the application of a multiple?

Dexter Braff: More value is often lost in determining the wrong measure of earnings than it is in determining the wrong multiple. First of all, the typical measure for that is earnings before interest, taxes, depreciation and amortization — the ubiquitous EBITDA that people talk about.

But there is a big question mark around whether that figure should be last year’s EBITDA, next year’s EBITDA, the most recent EBITDA annualized, and what that EBITDA is adjusted for if at all.

The term we like to use for the best measure of profit is “representative earnings”, which is essentially the earnings that would be expected over the twelve months following day the transaction closes. Buyers tend to look strictly at the trailing 12 months, which, particularly in fast-growing companies or companies seeing rate increases, is often not at all representative of what the next year will look like.
Braff: The only way to know that you’re getting a fair valuation for the business is to go out to multiple buyers at the same time. There’s simply no shortcut to that. Obviously people like us, that’s what we do for a living. It certainly can be done by a seller on their own, but rarely do they have the time, resources or expertise to orchestrate a strategically developed process and continue to run the business as successfully as they had prior to going to market. In fact, one of the first things we tell a prospective seller is that, if anything, rather than coast after they’ve made the decision to sell, they should focus even more resources on sustaining or growing the top line. Because nothing sabotages a deal faster than a decline in revenues after signing a letter of intent.

The quickest way to improve a multiple is to reduce risk. We already know sellers are always trying to increase their income and grow their business faster, that’s what business owners do on a day-to-day basis.

What we don’t talk about is how to change their risk. There are a variety of things that people can do to reduce risk, but among them is putting a management team in place that can run the business in the absence of the people that own it. Buyers are always concerned that after a transaction is completed, the principal will go away and the company might not have people in place to operate the business properly.

Diversifying referral sources also reduces the risk that if a seller loses a particular referral source or contract, the business is going to deteriorate quickly. The diversification of referral sources becomes a significant way to reduce the amount of risk.

There are literally dozens of items within a company that you can adjust to reduce the amount of risk attending to a transaction. Sellers need to look at the things that make the revenues and earnings steady, or that make them fluctuate. Anything that sellers can do to reduce that variability reduces risk, and therefore increases value.
Q: Behavioral Health Business: Finish this sentence:
The one thing a seller should seriously consider before contemplating a sale is…

“…bringing in third-party consultants to evaluate regulatory and clinical compliance, minimize risk, and ensure that a deal is completed at the price and terms agreed to prior to due diligence.”