



# MarketWATCH

## Healthcare Staffing

2008

*Of all the sectors The Braff Group covers, the healthcare staffing market is one of the most interesting. In an environment where the demand for nurses and other healthcare professionals far exceeds supply – and is expected to stay that way for the foreseeable future – one might expect to see healthcare staffing providers in the midst of a run-up in growth and profitability. Correspondingly, given a market that is exceedingly fragmented, much like the home healthcare industry, one would anticipate an extremely vibrant, and escalating merger and acquisition market. However, from a financial performance and M&A perspective, the realities of healthcare staffing, while still promising, have been somewhat mixed.*

**First, some of the numbers that characterize the healthcare staffing market.**

### Market Size, Segmentation, and Growth Trends

Healthcare staffing is typically broken down into four distinct sub-sectors with the following, general, characteristics:

- 1. Per Diem Nursing:** Temporary placement of nurses on a short-term, shift by shift basis.
- 2. Travel Nursing:** Temporary placement of nurses on a longer term basis, typically 13 weeks or more. Travel nurses are typically brought into facilities from outside the local area and are provided with housing, meal per diems, and other amenities. Although travel nursing is typically more expensive than per diems, hospitals often prefer travelers to limit demand for per diems and thereby encourage would-be per diems to perhaps apply for full-time placement as needed.
- 3. Allied Staffing:** Temporary placement of non-nursing, clinical professionals, on a per diem or travel basis. These professionals include, among others, physical, speech, and occupational therapists, pharmacists, and x-ray technicians.
- 4. Locum Tenens:** Temporary placement of physicians.

**CHART A:**  
Healthcare Staffing  
Revenue Trends

Revenue Trends – Billions							
	2003	2004	2005	2006	2007	2008P	2009P
Locum Tenens	1.0	1.1	1.2	1.4	1.6	1.9	2.2
Per Diem Nursing	4.7	4.2	4.1	4.1	4.1	4.1	4.1
Travel Nursing	2.3	2.1	2.1	2.3	2.4	2.5	2.5
Allied - Other	2.2	2.4	2.6	2.9	3.2	3.5	3.9
<b>Total Healthcare Staffing</b>	<b>10.2</b>	<b>9.8</b>	<b>10.0</b>	<b>10.6</b>	<b>11.2</b>	<b>12.0</b>	<b>12.8</b>
Revenue Trends – Growth Rates							
	2003	2004	2005	2006	2007	2008P	2009P
Locum Tenens	16.5%	11.0%	12.0%	13.5%	16.0%	17.5%	16.0%
Per Diem Nursing	-13.4%	-9.0%	-3.0%	0.0%	0.0%	0.0%	0.0%
Travel Nursing	-8.5%	-8.5%	1.0%	8.0%	3.5%	3.5%	3.5%
Allied - Other	-4.5%	9.0%	9.0%	10.0%	10.5%	11.5%	11.0%
<b>Total Healthcare Staffing</b>	<b>-8.5%</b>	<b>-3.0%</b>	<b>2.5%</b>	<b>6.0%</b>	<b>7.0%</b>	<b>7.0%</b>	<b>7.0%</b>

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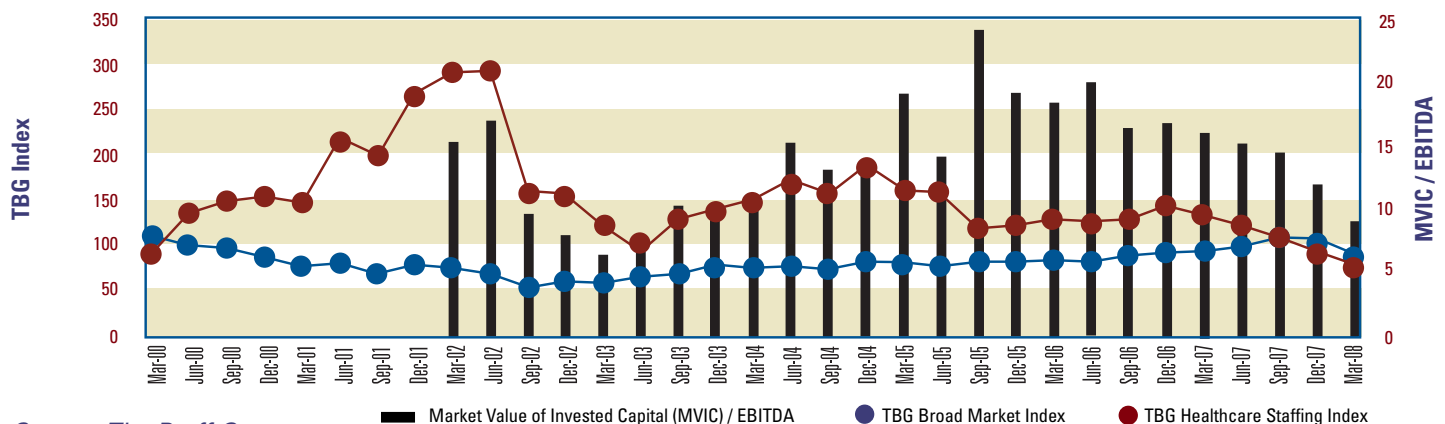
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As **Chart A** (previous page) indicates, while the overall staffing market has rebounded nicely since contracting in 2003 and 2004 (when hospitals aggressively, and in retrospect, likely overzealously cut back utilization of temporary staffing), some sub-sectors are faring substantially better than others. Notably, while per diem and travel nursing are projected to grow zero and 3.5% respectively in 2008 and 2009, anticipated growth for allied and locum tenens over the same period is more than 11% and 16% respectively. While many factors come into play, the primary reason for the markedly different growth trends is that while clients generally perceive nurses as pure “expense,” physicians and other allied professionals are considered “revenue generators.” As such, healthcare institutions are far more motivated – and willing to pay – to fill vacant physician and allied positions than they are nursing positions. Not surprisingly, this economic perception is reflected in gross profit margins, where, for the most part, locum tenens and allied staffing can command greater margins, driving greater profitability.

Also noteworthy, regarding historical and projected industry growth trends, is the odd, but very real, situation that the shortage of clinical professionals that has ramped up **demand** for temporary help, has also impacted the **supply** of candidates to fill these positions. So growth is often far more a function of a company’s ability to recruit temporary staff than the ability to source new placement opportunities. In a down economy then, we may see “secondary” wage earners that have been out of the work-force, return for short-term, temporary assignments to supplement income, which could give an added boost to the healthcare staffing sector over the near term.

**The Public Markets** Its been a challenging ride for stocks that make up The Braff Group’s Healthcare Staffing Index. As indicated in **Chart B** below, after a substantial run-up from 2000 to 2002 (when the sector was led by RehabCare Group, the New York Stock Exchange’s best performer of 2000), market prices tumbled dramatically in 2003 as the industry contracted (as discussed above). Since then, after modest rebounds from late 2003 through the end of 2006, the index has slid further, dipping below the initial threshold level of 100 in October of 2007. We suspect that the reasons for this are four-fold: First, as reported by *Staffing Industry Analysts* in its 2007 Healthcare Staffing Growth Assessment Report, average gross profit margins for the publicly traded healthcare staffing firms they track – perhaps the most significant predictor of potential profitability – have fallen from 25.5% in 2000, to a low of 22.3% in 2004, rebounding slightly to 22.9% in 2006.

**CHART B:**  
TBG Healthcare Staffing Vs. Broad Market Index VS. MVIC/EBITDA



Source: The Braff Group

With modest margins to begin with, a margin erosion of 10.2% (25.5% to 22.9%) is significant. Second, although allied and locum tenens have shown substantial growth, overall market expansion has been tempered by slow to no-growth trends for per diem and travel nursing, constraining investor optimism. Third, many of the publicly traded firms “grew up” with a foundation in per diem and travel nursing, and have had to rely on acquisitions of allied and locum tenens providers to develop their capacities in these spaces – opportunities that are extremely limited. Finally, we suspect that healthcare service investors that were previously drawn to staffing have shifted their interest to home healthcare and long term care, two healthcare service sectors that have fared particularly well over the recent past, closing with April 30, 2008 TBG Index averages of 712.6 and 532.5 respectively (compared to a close of 74.1 for healthcare staffing).

**Public Market Valuations** As illustrated in **Chart B**, valuation benchmarks for the publicly traded staffing companies we track, followed a path similar to our index, except for the period between March 2005 and March 2006, when median multiples of earnings before interest, taxes, depreciation, and amortization seemed to rise (or remain disproportionately high) despite steady declines in the public markets. In taking a closer look at the numbers, it appears that this seeming anomaly occurred as a result of fluctuations in stock price and earnings in which either (a) one or more companies’ decreases in stock prices were far less than that of earnings, or (b) one or more companies’ increases in stock prices were far greater than that of earnings (both of which would cause a spike in multiples of EBITDA). This type of market response was likely a natural reaction to the steady “post-plunge” run-up in the market that ran from July 2003 through December 2004, a period during which some “over-exuberance” may have developed. Predictably though, the market began to “correct” over time to levels that better reflect the challenges the sector faces today. The good news is that valuation metrics have remained consistently above the lowest point reached in March of 2003. Moreover, with a median EBITDA multiple of 8.72 at March 31, 2008, the sector still carries a higher relative valuation than the much lauded home healthcare industry, which closed with a median EBITDA multiple of 8.55.

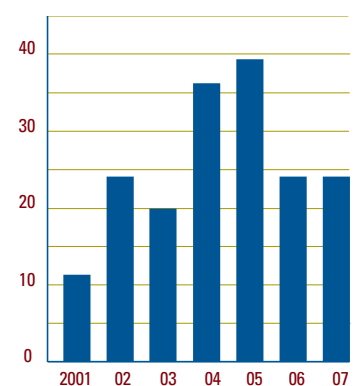
**Merger and Acquisition Trends** As we can see from **Chart C**, after achieving record transaction volumes in 2004 and 2005, deal activity in healthcare staffing fell-off somewhat in 2006 and held steady in 2007. While this might normally be a source of some concern, based on Braff Group research, we note that the 2004-2005 period was marked by a substantial number of “opportunistic” (i.e. somewhat distressed) transactions, predominately by small publicly traded companies that targeted the per diem sub-sector to capitalize on a market facing substantial margin erosion and capture top-line growth. As margins continue to be squeezed in per diem, several of these consolidators have faltered, notably World Health Alternatives. Furthermore, acquisition demand for per diem has predictably slackened. Conceptually, then, if we adjust for the 2004-2005 surge in opportunistic deals that, arguably, artificially inflated transaction activity, we would get a far different picture of acquisition trends – a picture revealing a relatively consistent range of 20-25 deals per year.

**But there’s more to the story.** The nature of staffing transactions has also changed dramatically over the recent past. Before per diem began to be squeezed, the sub-sector accounted for a substantial portion of deal flow in the run-up from 2001-2003. Since then, buyers have increasingly focused on – generally in order of preference (and relative valuation) – locum tenens, allied staffing, and travel nursing.



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**CHART C:**  
Healthcare Staffing M&A  
Transaction Trends



Source: The Braff Group

## the braff group

*The Braff Group is the leading investment banking firm specializing in the home health care, hospice, infusion therapy, specialty pharmacy, health care staffing, and home medical equipment market sectors. We provide an array of transactional advisory services including sell side representation, debt and equity recapitalizations, strategic planning, and valuation.*

The challenge, however, is that while the demand for these providers has spiked, the supply of potential acquisition candidates is quite limited. As such, the impact of this shift in interest has, to date, only marginally impacted the transaction trends highlighted above. With entrepreneurs developing new businesses in these areas, in part, to capitalize on this apparent gap between supply and demand, we anticipate increased deal volume as these firms mature and become more viable – and highly sought after – acquisition candidates.

A final note worth mentioning. In terms of deal size, the sector has also been well represented among the largest transactions. From 2006 to 2007, healthcare staffing has accounted for 25% of the Top 10 Deals of the Year.

**Merger and Acquisition Outlook** *In consideration of all the above, we expect the near-term outlook for merger and acquisition activity in the healthcare staffing sector to be generally favorable, and particularly vibrant in certain sub-sectors.*

- 1.** Given the substantial fragmentation in the industry – *Staffing Industry Analysts* estimates that the top 10 healthcare companies account for only 39.8% of total industry revenues – there is room for continued, and economically viable, consolidation. This is particularly true for travel nursing providers, that, in many cases, can effectively leverage their recruitment, deployment, management, and information technology infrastructures to capture additional margins from acquisitions.
- 2.** With allied staffing and locum tenens providers a) showing the greatest near term growth potential, (b) generating the most attractive margins, and (c) in a consolidation phase where acquisition demand from buyers looking to get into the space and/or capture greater share far exceeds supply, the M&A outlook for these providers in terms of deal volume and valuation will remain extremely attractive for the foreseeable future.
- 3.** Even in the face of falling stock prices, median EBITDA valuation multiples for the public companies we track is still at a reasonably attractive 8.5 X. Consequently, private equity remains interested in the space – Goldman Sachs led the acquisition of NurseFinders in 2007 – and opportunity remains for many publicly traded and large privately held companies to capture favorable “arbitrage” from acquisitions at aggressive valuations, even before factoring in profit enhancing synergies.



### **A Brief Look at Permanent Placement**

Unlike staffing models, where providers pay a fee to “rent” a healthcare professional for a discreet, but temporary period of time, in permanent placement, as the name would suggest, providers are paid a fee to recruit and place a healthcare professional in a client’s organization on a permanent basis. Given that both models serve the healthcare human resource needs of clients, and that it is not uncommon for temporary staffing providers to allow for a conversion of a temporary placement to a permanent position (for a fee), permanent placement is considered by many to be a related service. That said, the businesses are quite different in terms of marketing, contracting, recruiting, fee structures, etc. As such, while offering permanent placement services may be a natural extension for diversified staffing providers to offer clients a more complete continuum of service, with their different core competencies, developing permanent placement organically can be extremely challenging. Additionally, because in some cases, one service can “cannibalize” the other, it is often best to house, market, and manage temporary staffing and permanent placement separately. Not surprisingly then, perhaps the best route for diversified staffing providers to develop a permanent placement capacity is through the acquisition of fully developed, stand alone perm companies. Perhaps the “poster child” for such an acquisition strategy was AMN Healthcare’s 2005 acquisition of Merritt Hawkins (MHA). Even today, while there is brief mention of the affiliation of both companies on their respective websites, MHA still retains its own website and, more importantly, its own market identity. With many diversified providers looking for new product extensions and growth engines, and with an extremely limited number of fully developed, permanent placement acquisition candidates, we expect to see more transactions, at attractive valuations, in this unique sub-niche.