

TAX INCENTIVES CONTRIBUTE TO RECORD YEAR IN BROAD HEALTH CARE SERVICE M&A ACTIVITY

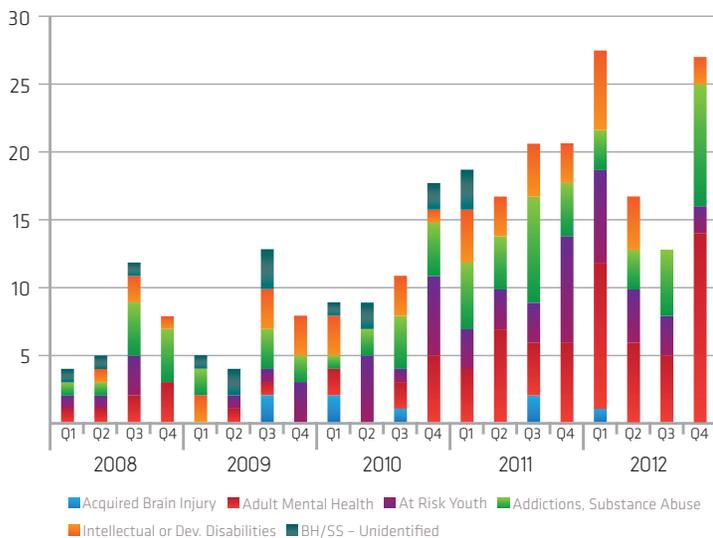
With the expiration of the Bush Tax Cuts and the implementation of a 3.8% surtax on capital gains scheduled for December 31st, we predicted a surge in M&A activity in the third and fourth quarter as sellers sought to maximize their post-tax returns. It came as no surprise, then, that after a third quarter that produced the second highest tally of behavioral health and social services, home health, hospice, pharmacy service, and home medical equipment M&A transactions since we began cataloguing deal flow in 2001, the fourth quarter delivered even better results. With a record 106 deals in Q4, 2012 closed out at a new high with 379 deals, up 12% vs. 2011.

It should be noted, however, that these external tax considerations add considerable “noise” to any trend analysis. Bearing this in mind, however, below is our view on behavioral health and social service M&A activity for the year.

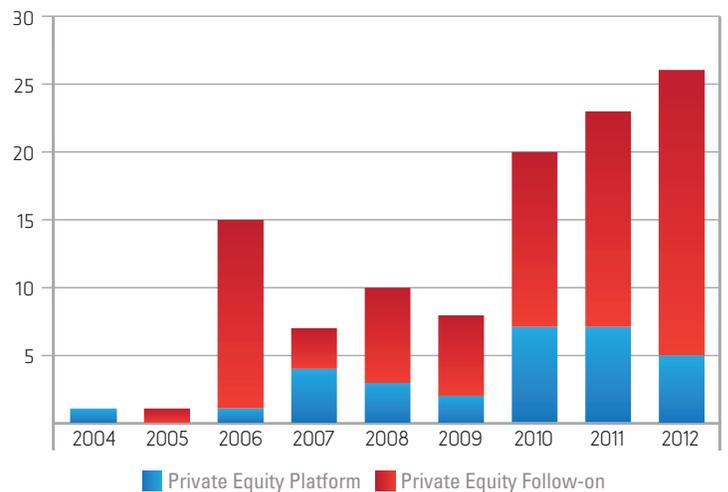
Behavioral Health and Social Services Transaction Volume Rebounds Dramatically

In our previous *marketWATCH* report on behavioral health and social services last fall, we noted the first meaningful and successive quarterly declines in deal flow (second and third quarter, 2012) since the run-up in BH/SS activity began in 2010. At the time, we also hypothesized that this development was not a function of a fundamental change in the M&A dynamics of the sector. Rather, we theorized that the fall-off was likely due to a temporary shift in supply and demand, particularly as it relates to private equity, as (a) rapidly consolidating acquirers temporarily slowed down to “digest” their recent transactions (demand), and (b) after such a rapid ascent of deal flow, the pipeline of acquisition candidates had temporarily diminished (supply). Accordingly, we anticipated a rebound in deal flow as supply and demand normalized.

Behavioral Health & Social Services Deal Trends



Private Equity Investment in Behavioral Health & Social Services



Source: The Braff Group

With a fourth quarter surge in deal flow of nearly 108% vs. the third quarter producing the second highest quarterly tally since we began tracking the sector in 2005 (27 deals), tax considerations alone are not enough to explain the rally. Moreover, after going nine months without a single new platform investment from private equity, we identified a record five such transactions in the fourth quarter alone.

Taken together then, after trailing 2011 by more than 5% going into the fourth quarter, 2012 narrowly eclipsed the previous year's record high of 83 deals, closing out at 86 transactions, the fourth consecutive year of record breaking M&A activity in behavioral health and social services.

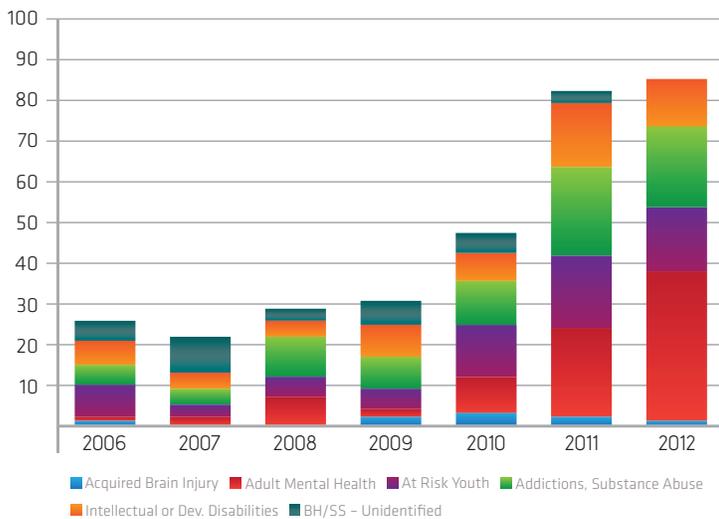
Also notable is that while the volume of transactions involving **addictions and substance abuse** providers has been at or near the top of all the sub-segments we track in behavioral health and social services for the past four years, **adult mental health** deal flow soared 68% in 2012 (37 deals), assuming first position and accounting for 43% of all BH/SS activity.

Outlook. Although the sharp growth in BH/SS M&A activity has slowed, the primary drivers of this surge (below) remain in place.

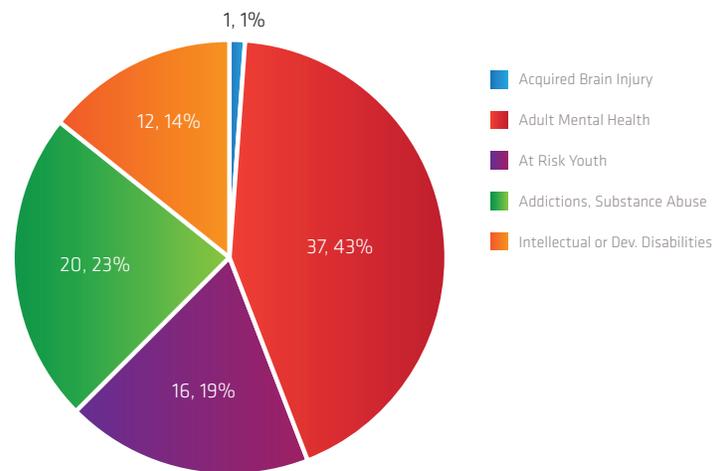
- increased awareness and acceptance of behavioral health services
- up to 30 million newly insured beneficiaries via health care reform
- reimbursement parity initiatives
- a still widely fragmented market
- all supported by a growing list of private equity investors

Taken together, these factors should contribute to a sustained period of vibrant acquisition and divestiture opportunities for the foreseeable future.

Behavioral Health & Social Services Deal Trends



2012 BH/SS Deals by Segment



Source: The Braff Group

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