the braff group

marketWATCH

BEHAVIORAL HEALTH

BEHAVIORAL HEALTH AND SOCIAL SERVICES DEAL VOLUME SOARS

As we have previously reported, after posting record activity in the fourth quarter of 2012 (as sellers looked to lock in favorable tax rates that were set to expire at year end), virtually every segment in health care services (as well as the M&A market as a whole) plunged dramatically in Q1 2013. The same was true in Behavioral Health and Social Services (BH/SS).

However, based on proprietary data compiled and analyzed by The Braff Group, deal volume rebounded substantially in the second quarter with 23 transactions (in aggregate), up nearly 44% over the first quarter, and up 35% vs. the same period last year.

Moreover, the 23 deals was the third highest quarterly tally since we began tracking the space in 2006. In particular, the M&A market for addictions and substance abuse providers (ASA) continues to shine. **In fact, ASA is the most robust segment in health care service mergers and acquisitions– by a wide margin.**

Consider the data:

When we compare transaction volume for the past four quarters (ending Q2 2013) vs. the prior four quarters (ending Q2 2012), ***ASA activity surged more than 83%.***

Of all the other segments we track in behavioral health and social services (acquired brain Injury, adult mental health, at risk youth, intellectual or developmental disabilities), as well as home health care, hospice, home medical equipment, pharmacy services, and health care staffing, ***the next highest 4 quarter growth was in Specialty Pharmacy at just over 27%.***

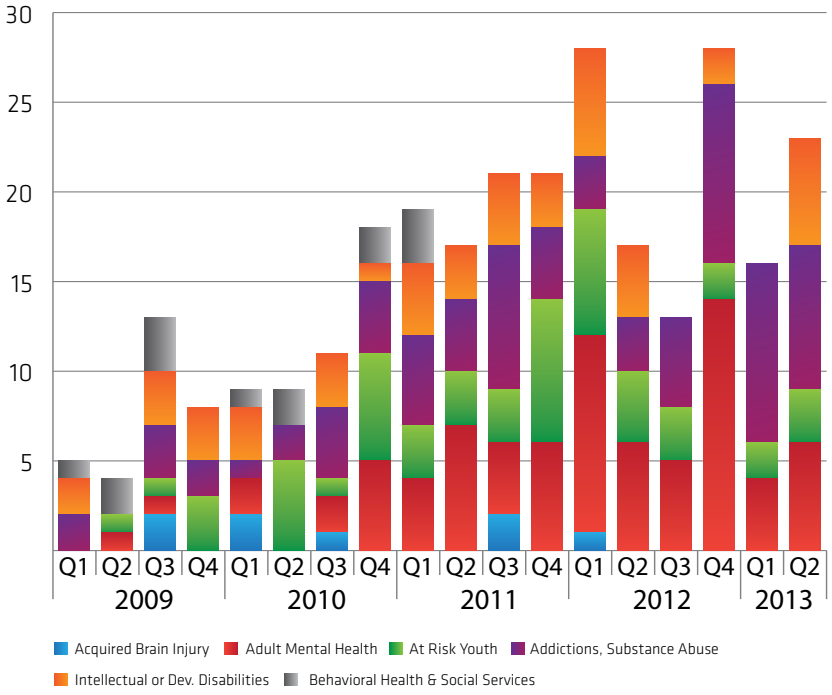
Over the past four quarters, there ***were six new private equity sponsored platform investments*** in addictions and substance abuse (PE investment trends are frequently a leading indicator of accelerating market consolidation).

In the prior four quarters, there were three.

As stated above, the M&A market ***plunged dramatically in Q1 2013 after a fourth quarter frenzy fuel by tax incentives.***

Not so in addictions and substance abuse, as in Q1 2013, ***the sector actually matched its record output tallied the previous quarter.***

Behavioral Health and Social Services Deal Trends



Source: The Braff Group

The reasons? Differentiated services. High touch, high margins. Growing market awareness. Parity. Increased utilization. High private pay, private insurance vs. Medicaid. Frequent real estate component.

And the go-forward outlook remains impressive. The surge in addictions and substance abuse transaction volume has substantially increased its market visibility, which, in turn, has stimulated further sector interest. Moreover, buyers are coming from multiple directions – private equity, existing strategic players, ancillary behavioral health care service providers, and not-for-profits. Combined, these factors contribute to acquisition demand that far exceeds supply, which The Braff Group fully expects will support a continued competitive and vibrant M&A market. A market which will also support premium pricing in a well-orchestrated divestiture strategy.

Other Developments of Note

Private Equity Continues to Invest Heavily in Behavioral Health and Social Services

Again, based on proprietary data gathered by The Braff Group, there were 11 PE sponsored transactions (3 platform entry and 8 follow-on investments) in the second quarter of 2013, just a few deals shy of the record tallied in the tax driven fourth quarter. Moreover, indicative of the sustained investment interest in BH/SS, Q2 marked the third consecutive quarter of elevated private equity investment activity.

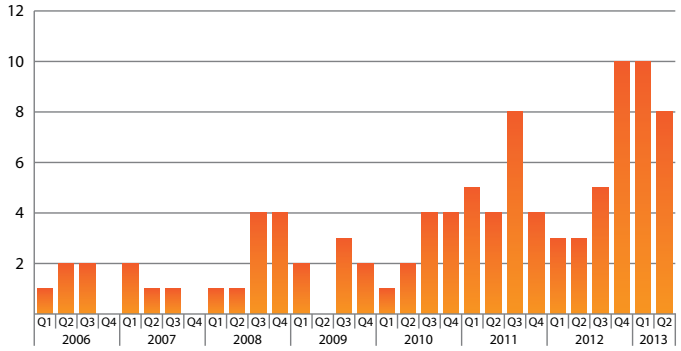
As we have laid out in previous editions of ***marketWATCH***, even with challenges in Medicaid state funding, the overall climate for behavioral health and social services is decidedly more favorable than other health care service sectors that have been battered by sustained reimbursement cuts and intense regulatory oversight (home health – repeated price cuts with more to come, and increased penetration of Medicare managed care; hospice – increased scrutiny of lengths of stay and payment for patients residing in skilled nursing facilities; home medical equipment – competitive bidding price cuts of 45%; pharmacy services – intense margin compression as competitive differentiation morphs from service to efficiency).

Additionally, comparatively speaking, of all the health care service sectors we cover, behavioral health and social services is at the earliest stage of consolidation. Accordingly, while overall health care service M&A activity remains relatively robust, there is simply more go-forward opportunities to consolidate and create critical mass in both service and coverage in BH/SS.

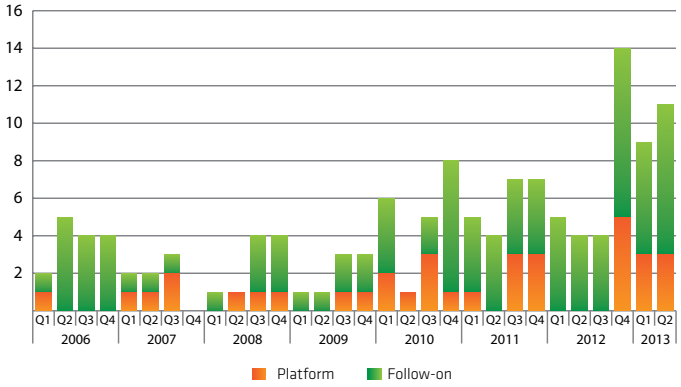
Strong Quarter for Providers Focused on Individuals with Developmental Disabilities

After recording only two transactions over the previous three quarters ***combined***, Q2 was a break out quarter in IDD with six transactions. In particular, we note increasing acquisition demand for IDD companies specializing in autism services as buyers seek to further differentiate themselves in the market and create sustainable competitive advantages.

Addictions & Substance Abuse Deal Trends



Private Equity Investments Trends in BH & SS



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Source: The Braff Group