marketWATCH

BEHAVIORAL HEALTH & SOCIAL SERVICES

BEHAVIORAL HEALTH AND SOCIAL SERVICES M&A CONTINUES TO ROLL AS TWO GIANTS CONSIDER EXITS

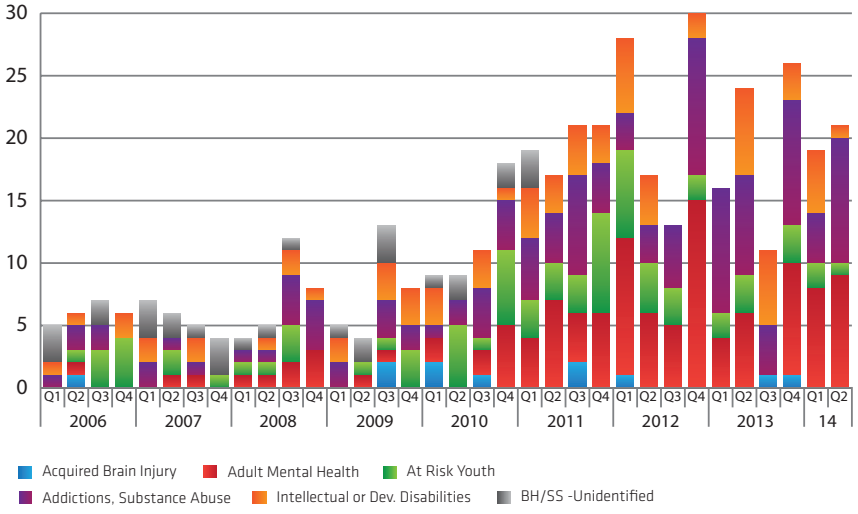
Based upon proprietary data collected and analyzed by The Braff Group and illustrated in the chart below, mergers and acquisitions activity in behavioral health and social services remains extremely vibrant. Transaction volume during the second quarter was up slightly over the past quarter with 21 transactions (vs. 19 in Q1). Furthermore, through the first six months of the year, the sector has recorded 40 transactions, equaling the number of deals completed over the same period in 2013. If deal activity remains at its current pace, BH/SS will generate 80 transactions, marking the fourth consecutive year of steeply elevated activity (in 2010, the sector recorded 48 deals).

When we break down the numbers further, addictions and substance abuse treatment providers once again topped the chart with ten deals recorded in the second quarter, followed closely behind by mental health with nine transactions. Providers serving at risk youth and individuals with intellectual and developmental disabilities accounted for one deal each. Over the past 12 months however, I/DD accounted for 19% of behavioral health M&A activity (15 transactions).

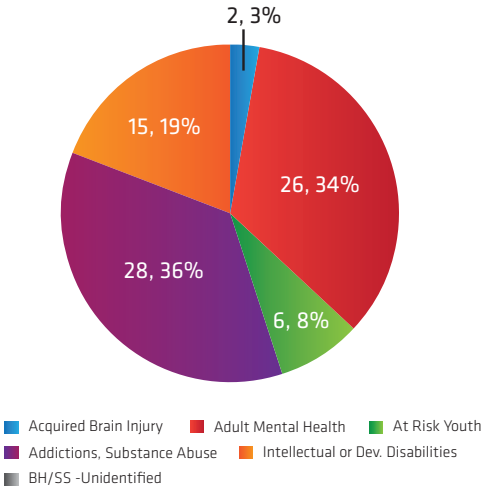
While I/DD has been overshadowed by the frenzy of activity in addictions and substance abuse and mental health, it will garner quite a bit of attention over the next few months as private equity sponsors of two of the largest providers consider cashing out.

In May, private equity sponsor Vestar Capital Partners announced its intention to prepare **National Mentor Holdings** for an initial public offering. According to an article appearing in the Wall Street Journal, "people familiar with the matter" say that "the potential offering could value the Boston based company at $1 billion, including debt."

Behavioral Health and Social Services Deal Trends



Behavioral Health and Social Services Deals by Segment for the Trailing 12 Months



Perhaps not so coincidentally, shortly thereafter, Reuters reported that Canada based private equity firm Onex Corp engaged advisors to explore a possible sale of **ResCare**, which, according to another group of "people familiar with the matter," could "fetch a price of more than $1 billion." (Apparently there are lots of people familiar with lots of matters.)

Anyone interested in the go-forward M&A and investment prospects for companies focused on serving individuals with developmental disabilities should watch these developments closely. First, Mentor's recently filed S-1 registration documents (and perhaps those of ResCare, if it decides to go down the public offering route) will offer industry insiders an unprecedented peek inside the strategic vision, as well as financial, infrastructure, and marketing operations of one of the country's largest I/DD providers. Second, Mentor's stock pricing and ResCare's valuation (which, although private, will reverberate through the financial grapevine as quick as a flash-trade) will likely influence defacto valuation metrics across the segment. If they are strong, they may lift the multiples across the spectrum of providers which, we believe, have been weighed down by particularly sticky "rules of thumb" that undervalue the risk-return fundamentals of I/DD. Finally, if the deals are successful, they will surface even more prospective PE sponsors and strategic buyers, perhaps tilting the balance of supply and demand, now largely in the buyer's favor, a few ticks towards seller's.

Accountable Care Organizations and Behavioral Health. Another developing trend worthy of note: recently we attended a national summit on population health management during which a variety of health care institutions discussed strategies they have implemented to reduce cost, improve outcomes, and enhance patient satisfaction through coordinated care initiatives, including the formation of accountable care organizations (ACOs). (See our recent edition of **viewPOINTS** entitled, ***"ACOs. Here to Stay? Does it Pay? And Should You Play?"***) Among a number of interesting revelations was the fact that virtually every presenter concluded the need to integrate behavioral health services in a successful coordinated care program. As we have noted before, while long-term acute-care hospitals, skilled nursing facilities, home health and hospice have been the focal points of the first wave of acute and post-acute integration, behavioral health will not be far behind, further enhancing its visibility, utilization, and long-term M&A opportunity.

Clearly, the beat goes on in behavioral health and social services.

But, even if this wasn't the case, ***you may be worth more today than you were a year ago.***

Here's why.

Though the economy may feel like it's merely plodding along, don't tell the investment community. The M&A market is cruising toward a dot.com like swell that inflates, to one degree or another, the value of companies across virtually all sectors. ***So, if your health care service sector is on the rise, it is even more so. And if it's under pressure, it is less so.***

As we expound upon in greater detail in our recently released **viewPOINTS** publication entitled, ***"Are We Approaching an M&A Bubble?",*** the evidence is all around us.

Valuations for technology companies are rebooting to the logic defying levels we saw during the early 2000s when Wall Street seemingly adopted ***The Absolute Value Method*** for pricing companies: applying triple digit multiples to the absolute value of **losses** generated by the NEXT BIG THING (like Snap Chat, the no revenue app that recently received an investment valuing the company at $10B). So the greater the red ink, the higher the valuation. What a country.

Debt is flowing again to levels we haven't seen since 2007. Private equity groups and corporations have amassed more than $2 trillion (with a "T") in cash just waiting to be invested. The stock market is trading at 3,000 points higher than the peak reached at the height of the last bubble. And all of the above has coalesced to drive acquisition demand and activity to levels out-pacing the boom that preceded the 2008 bust.

So if you metronome back and forth between holding and selling, it may be worth considering that bubbles don't come around that often, and when they do, they can evaporate as quickly as a Snap Chat message (or valuation). Just sayin.

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