the braff group

marketWATCH 2012

ADDICTIONS AND SUBSTANCE ABUSE TREATMENT PROVIDERS

From a mergers and acquisitions perspective, over the past 12-15 months, addiction and substance abuse treatment providers have emerged as some of the most sought after – and valuable – acquisition candidates in health care.

The reasons are both many, and compelling.

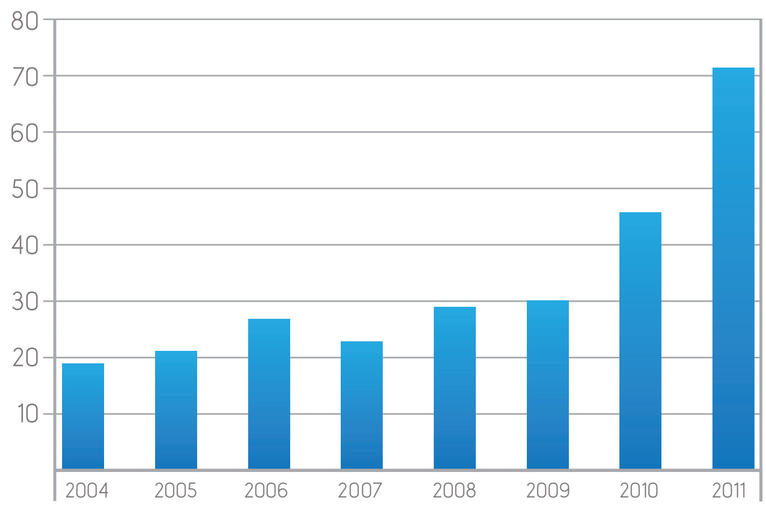
First and foremost, based upon proprietary Braff Group data as presented in the chart below, the entire Behavioral Health and Social Services (BH/SS) market sector has enjoyed an extraordinary surge of strategic and financial investor interest over the past two years.

Why Behavioral Health and Social Services is in the Merger and Acquisition Spotlight

Untapped Opportunity: After more than a decade of health care service consolidation in home health care, hospice, pharmacy services, and home medical equipment, behavioral health and social services remains relatively “pristine” and extremely fragmented. Accordingly, there is substantial untapped opportunity for buyers to acquire providers, develop critical mass, and gain competitive advantages.

Frequent Diversified Payor Mix: While specific segments or providers skew to certain payors, BH/SS reimbursement frequently comes from many sources including numerous Medicaid, Medicaid Waivers and other state funded programs (often across multiple states), Medicare, private insurance contracts, and private pay clients. Accordingly, many BH/SS providers are insulated from the financial devastation those with concentrated payor sources can experience with the “stroke of a pen”.

Behavorial Health and Social Services Deal Trends



Comparatively Strong Margins: With a substantial, and often clinically intensive, service component, profit margins in behavioral health and social services are frequently greater than 10%, and often approach 20% or more.

Competitive Advantages: Not only is BH/SS naturally service intensive, these services are not prone to “commoditization.” That is, research and treatment options are still evolving in many areas, enabling some of the most creative, innovative, and clinically focused providers to develop “signature” programs and protocols that are not easily duplicated. Accordingly, the best providers in the sector have developed the kind of competitive advantages that not only “lock in” referral sources, but also protect margins and create barriers to entry.

Promise of Increased Utilization: As a result of mental health reimbursement "parity" initiatives unveiled in 2010 and health care reform (which contains expanded parity requirements as well), not only will there be an increase in the number of insured beneficiaries, but these, and other beneficiaries will have greater access to BH/SS, portending a surge in utilization over the near term.

While behavioral health and social services, in general, has captured the M&A spotlight, addictions and substance abuse (ASA) treatment providers, in particular, have become the most sought after targets within the sector for the following reasons:

Predominately Private Pay/Private Insurance: With government funded health care – Medicare, Medicaid, Medicaid waivers, and other state funded programs – subject to the greatest reimbursement pressure, addictions and substance abuse, deriving much of its reimbursement from private pay or private insurance sources, is comparatively – and substantially – less risky than other segments in BH/SS.

Potential to Serve Affluent Populations: Though some of this opportunity has been temporarily blunted by the current recession, addictions and substance abuse providers frequently serve affluent populations that have the private insurance, or the means to pay out-of-pocket, to cover the kind of high margin, round-the-clock, intensive, therapeutic, and frequently residential, programs available.

Higher Margins, Higher Profitability: In concert with the bullet above, ASA providers tend to generate the highest profit margins within the behavioral health and social services sector.

High Barriers to Entry: Especially for residential treatment programs, it can be extremely costly – and time consuming – to develop the physical infrastructure, clinical programs, management infrastructure, reputation, and name recognition necessary to draw clients to facilities, frequently from out-of-state. Accordingly, established addictions and substance abuse providers command premium pricing – especially when current acquisition demand far exceeds supply.

Increased Acceptance of ASA Programs: Over time, addictions and substance abuse treatment programs have increasingly become more accepted by both potential clients and payors. Moreover, programs have gone far beyond alcohol and drug treatment to include, among others, eating disorders, sexual addictions, and gambling. Accordingly, in an increasingly stressed society, the need for these valuable programs is substantial, predictable, and growing.

Outlook for Addictions and Substance Abuse Treatment Providers.

Given all the above, we anticipate the acquisition demand for, and valuation of, ASA providers to be extremely high over the next 12-24 months. In particular, having spoken with numerous private equity groups seeking a foothold (and a management team to lead their efforts) in this lucrative market, we anticipate that over the near term, these financially driven buyers will lead the pack in transaction volume – and more importantly – pricing.

THE BRAFF GROUP DIFFERENCE

The Braff Group is the leading merger and acquisition advisory firm specializing in health care services including behavioral health and social services, home health care, hospice, infusion therapy, specialty pharmacy, health care staffing, and home medical equipment.

We provide an array of transaction advisory services including sell side representation, debt and equity recapitalizations, strategic planning, and valuation. Headquartered in Pittsburgh, PA, The Braff Group has satellite offices in Atlanta, Chicago, Ft. Lauderdale, and Palm Springs.

According to Thomson Reuters, for the three years ended 2010 – The Braff Group was ranked number one in Health Care Services merger and acquisition transaction volume.

Winner, Health Care Deal of the Year, 2004, 2005, 2006, and 2009.

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