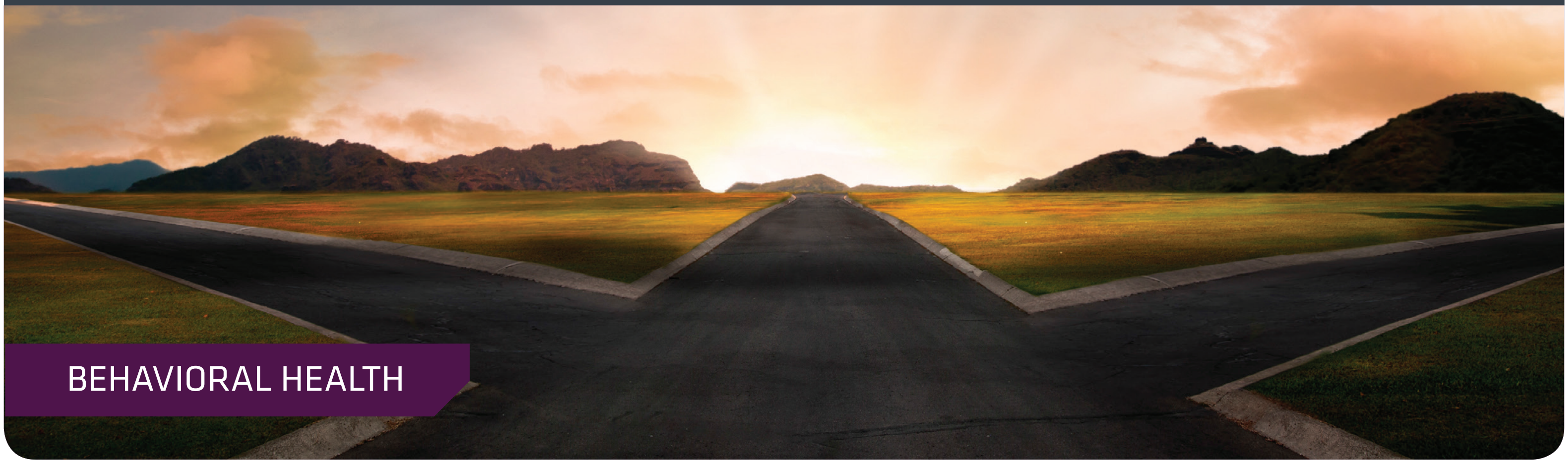
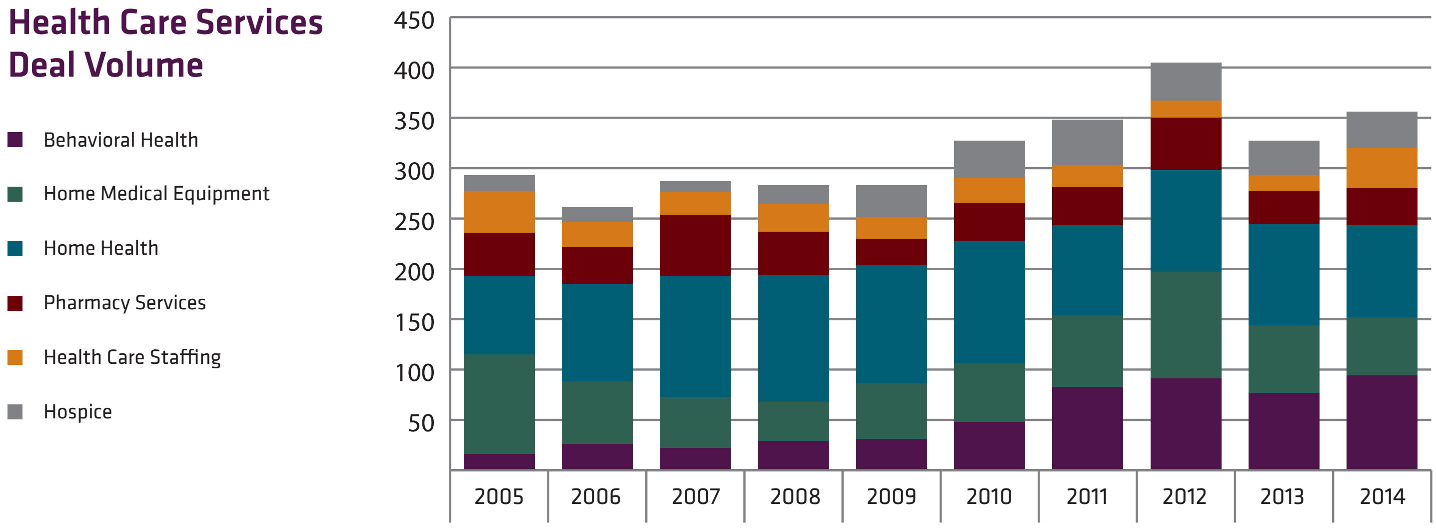


2014 M&A ROUNDUP:
RECORD DEAL VOLUME IN BEHAVIORAL HEALTH HELPS DRIVE A 9% GAIN IN OVERALL HEALTH CARE SERVICE ACTIVITY

Based upon proprietary data collected and analyzed by The Braff Group, every sector except home health and home medical equipment recorded year-over-year gains, propelling aggregate health care service deal volume up 9% over 2013. Moreover, if we exclude 2012, a year that was artificially juiced as sellers rushed the exits to beat an 8.3% increase in capital gains, 2014 was a record year, just eclipsing the tally posted in 2011.

The biggest winner was health care staffing, which rocketed 150% in 2014. With reduced unemployment and more beneficiaries (care of health care reform) accessing an already under-staffed health care system, the sector recorded its highest tally, by far, in nearly 10 years.

Health Care Services Deal Volume



Source: The Braff Group

Behavioral Health

When you include all the Behavioral Health segments (Addictions and Substance Abuse, Mental Health, At-Risk Youth, Intellectual and Developmental Disabilities, and Acquired Brain Injury), the sector has experienced dramatic and steady growth in M&A activity since 2010.

In fact, as illustrated below, after a modest dip in deal flow in 2013 following the great tax rush of 2012, **behavioral health M&A surged 22% in 2014 reaching a new all-time high of 94 transactions – the most of all the health care service sectors we cover.**

If we drill down further into the data, we can see that three of the four major segments of behavioral health posted strong M&A figures in 2014.

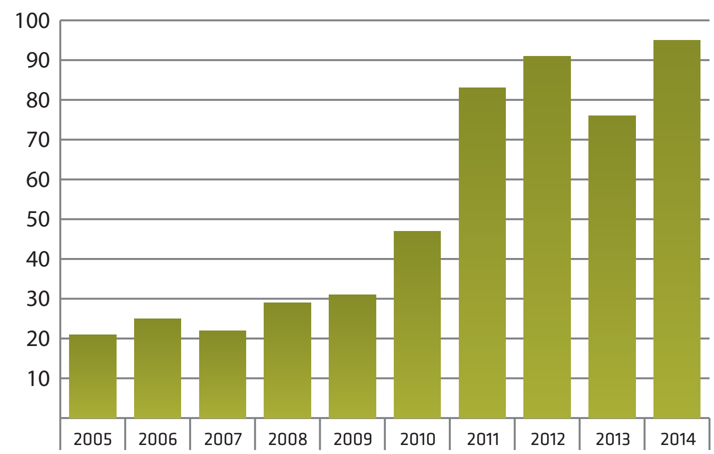
Mental Health

After a precipitous dive in 2013, **deal volume in mental health rebounded nicely in 2014, rising 78% vs. 2013.** That said, unlike other behavioral health segments and services which only recently began to consolidate in earnest, mental health is currently in its second wave of consolidation – the first beginning in the late 90s with the rise of Psychiatric Solutions and Universal Health Services (which merged in 2010). After initial periods of consolidation, which take many providers out of the market, secondary waves are often characterized by quick ramp-ups, followed by intermittent peaks and valleys of deal flow as a more limited pool of acquisition candidates consider potential exits. What's more, in secondary waves, we often see moves towards diversification as consolidators look to sustain steady growth when core acquisition opportunities are less plentiful (see our viewPOINTS white paper on urgent care consolidation for an overview of typical consolidation cycles). Accordingly, while generally elevated, we anticipate uneven deal volume in mental health over the coming years – and more deals like psychiatric hospital-focused Acadia's acquisition of methadone treatment-focused CRC.

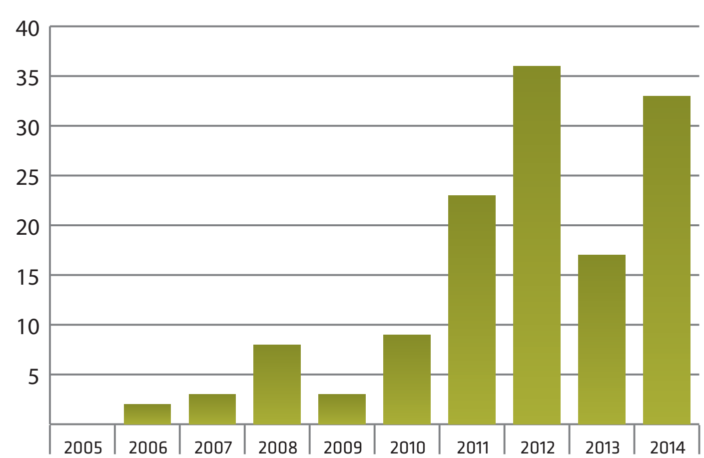
Individuals with Developmental Disabilities & Autism Spectrum Disorders

Perhaps more impressive, however, were the results in the individuals with developmental disabilities space. **With 25 deals completed during the year, I/DD smashed its previous record tally, set just last year, by 47%.** This surge was driven, in part, by a frenzy of activity around autism spectrum services. About 12-18 months ago, the convergence of (a) increased awareness of autism spectrum disorders, (b) greater emphasis on earlier diagnosis, and (c) ASD friendly insurance reform began to thrust autism services into the behavioral health M&A spotlight (a spotlight that was already burning brightly). Add to this the potential to build out multiple and diversified growth prongs – schools, clinics, at-home support services, extended coverage to age 21 and older – it's no wonder that autism service providers of all sizes have moved to the top of many a buyers' wish lists.

Behavioral Health Deal Trends



Mental Health Deal Trends



Source: The Braff Group

Addictions and Substance Abuse Treatment Providers

2014 was also a strong year in addictions and substance abuse, as the segment matched its record tally of 32 deals set in 2013. What's more, ASA produced two of the most notable, attention grabbing deals of the year.

First was the remarkably successful **initial public offering for American Addiction Centers** in October. As we wrote about extensively in our marketALERT publication, A Peek Inside American Addictions Centers' Initial Public Offering: Implications for the Industry, at its offering price of $15.00 per share, the company debuted on the market with a heady valuation of 2.53 x trailing 12 month revenues and 22 x adjusted earnings before interest, taxes, depreciation and amortization.

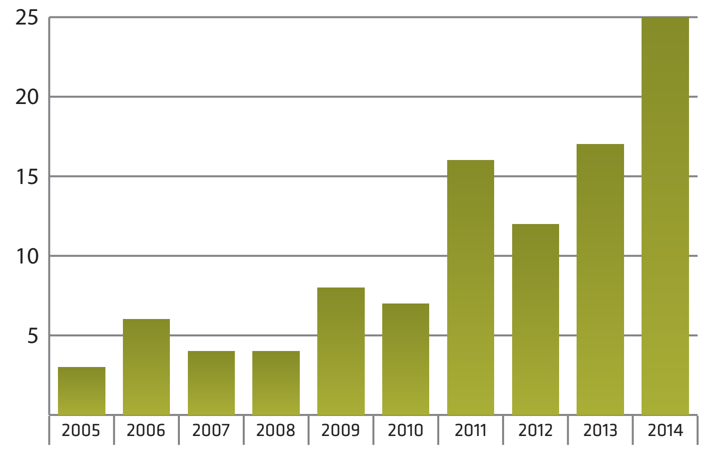
Head turning as that was, consider the following: At the end of the first week of trading, the stock closed at $18.65 – up 24% from its initial offering price. Just four months later, as of February 6th, 2015, the stock was up another 53%, closing the day at $28.66. **Based upon a trailing 12 month basis, American Addictions is currently valued at an eye-popping 5.37 x revenues and 41.4 x EBITDA.**

This gives AAC a decided advantage when it comes to financing acquisitions.

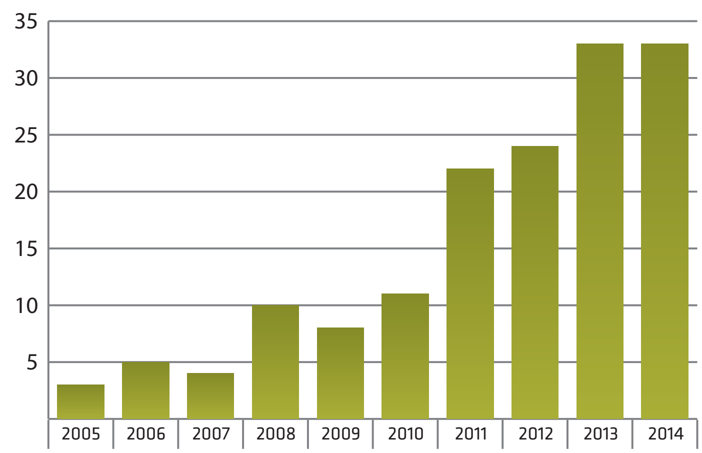
At such a lofty valuation, their stock is arguably worth more than cash. So, just as a strong dollar effectively lowers the price of foreign goods, American Addictions can wield its stock currency to extract greater returns from their acquisitions. No surprise then that in their most recent deal – the acquisition of Clinical Services of Rhode Island – two thirds of the purchase price was financed with restricted stock. Interestingly, AAC will likely be prudent in using its paper, as it must balance its desire to leverage its buying power with the downside that the Wall Street wonks are reflexively wired to see this as an indication that management may think its stock is over-valued. While we are not suggesting such is the case here, in such a volatile, perception driven market, financing deals with stock can be a delicate balancing act. But expect to see more of this from American Addictions if its stock continues to perform well.

2014 also produced the blockbuster acquisition of CRC by Acadia. (See our marketALERT publication, *Acadia buys CRC: The Valuation, Rationale, and Why You Should Care.*) On its sheer size alone ($1.125 billion), the deal not only further increased the visibility of addictions and substance abuse, it demonstrated that the segment can support exits of this magnitude – a development that can usher in consolidation of the consolidators themselves.

Individuals with Developmental Disabilities Deal Trends



Addictions & Substance Abuse



Source: The Braff Group

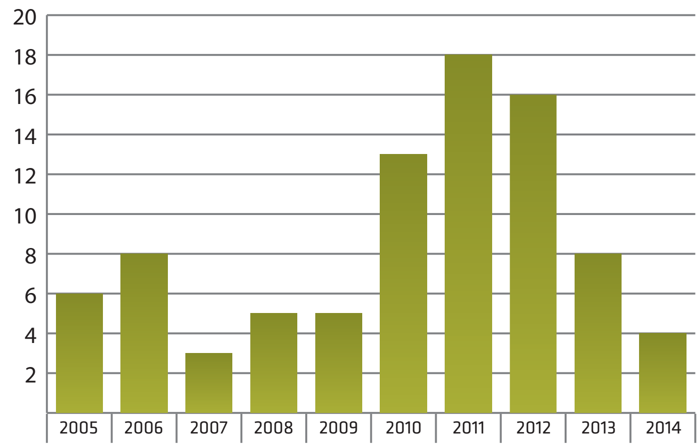
At-Risk Youth

With all the positive mojo in behavioral health, the substantial decline in M&A activity in at-risk youth services is particularly stark in contrast. Our read of this is that the fall-off has less to do with any weakness in the risk-return fundamentals in ARY than it does with the somewhat greater allure in mental health, I/DD, and addictions and substance abuse. In sector centric mergers and acquisitions, investment activity is often a zero sum game. A rise in interest in one segment typically comes at the expense of another. In this case, we suspect that the acceleration of I/DD buy-out activity, in particular, may account for some of the decline in at-risk youth deal flow. With a decidedly bigger market, a boost from autism services, lower NIMBY (not-in-my-back-yard) barriers, and perhaps less perceived liability risks, I/DD may seem a better investment for buyers interested in behavioral health, but not wanting to compete for the more limited addictions and mental health treatment assets. This would suggest that the demand for at-risk service providers may ramp up over time as the behavioral health M&A market matures and providers look for service line extensions.

And the outlook for 2015?

As Bud Fox might say, “Blue Horseshoe loves Behavioral Health.”

At-Risk Youth



Source: The Braff Group

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Since the firm’s inception in 1998, we have closed more than 250 transactions, more than any other mergers and acquisitions advisory firm covering like sectors.

According to Thomson Reuters, The Braff Group ranked # 1 in health care mergers and acquisitions advisory services in 2009, 2011, 2012, and 2013. Four Time Winner Health Care Deal of the Year.

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