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BRAFF

BEHAVIORAL HEALTH & SOCIAL SERVICES

BEHAVIORAL HEALTH KEEPS PACE WITH 35% SURGE IN OVERALL HEALTH CARE SERVICE M&A

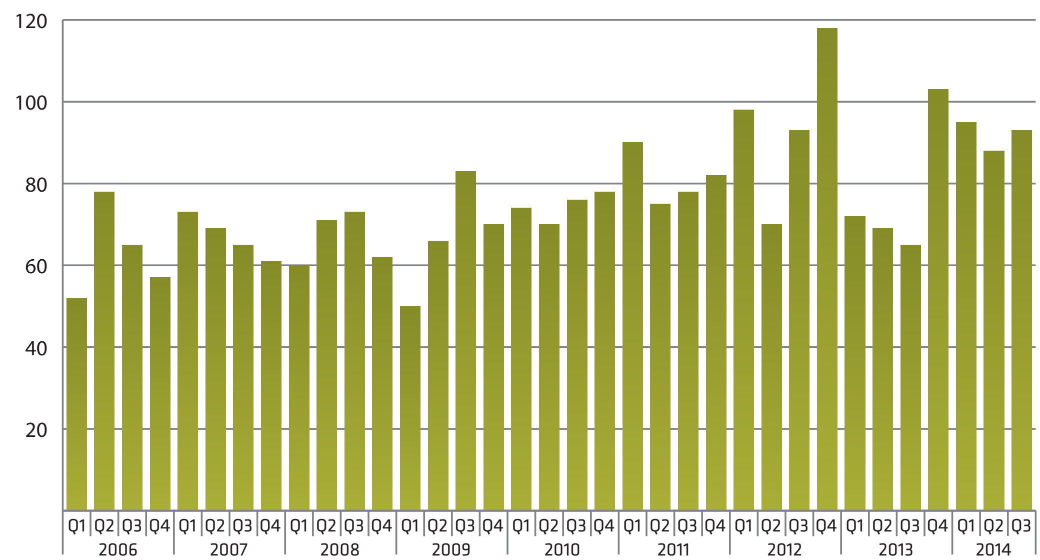
After an unexpectedly sluggish first quarter for health care service deals in aggregate – results that were consistent with other investment data points reported by other outlets – we went on record suggesting that with *"far more evidence to predict an upswing than there is to explain a downturn … we anticipate another strong year of volume and valuation."*

As it turns out, we're pretty good at reading the tea leaves.

Based upon proprietary data collected and analyzed by The Braff Group and illustrated below, despite the slow start, **aggregate deal volume through the third quarter year-to-date is up a stunning 34% in 2014 vs. the same period last year.** Notably, Q3 2014 results alone were more than 40% ahead of the same period last year.

Furthermore, the past four quarters have produced the most transactions – 379 – that we have ever seen during any previous four quarter period — far more than the then record tallies posted in 2010 and 2011 as recession weary investors turned to recession resistant health care, and just eclipsing the four quarter period in 2012 that culminated with the all-time record tally for a single quarter as sellers rushed to beat expected increases in capital gains taxes.

All Health Care Services Deal Trends



As is evident in the figures below, every sector has contributed to the M&A blowout with behavioral health and social services generating 37% growth in 2014 year-to-date. But even a 37% pop wasn't enough to out-deal health care staffing which has rocketed 288% due to (a) a declining unemployment rate and (b) speculation that the shortage of doctors and nurses will be even shorter given reform initiatives.

Within the overall behavioral health and social services sector, t**he biggest gainer thus far in 2014 has been mental health,** which, at 26 deals year-to-date, not only kicked in the highest growth rate (160%), but has also leapfrogged **addictions and substance abuse** for the top spot in behavioral health deal volume. Also quite notable is the 50% spike in **intellectual and developmental disabilities** provider transactions.

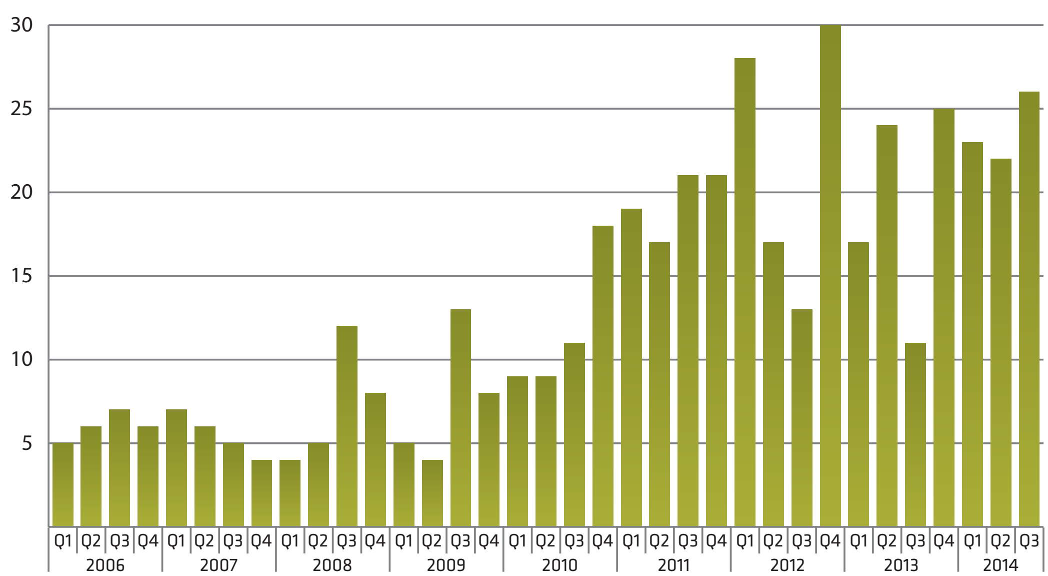
With the growing presence of these sub-segments, **we are in perhaps the most balanced period of behavioral health transaction activity – a period providing excellent exit opportunities for providers across the entire spectrum of behavioral health.**

What's more, the past few months have produced some of the largest deals that we have seen in recent memory, highlighted by acquisitions of **CRC Health** by **Acadia,** and by the extremely successful initial public offering completed by **American Addictions Centers,** which was originally priced at a multiple of 22 x EBITDA and is currently trading at a valuation multiple hovering around 50 x (see The Braff Group's recent publication, *marketALERT: A Peek Behind American Addictions Centers' IPO,* for more details).

Third Quarter 2014 M&A Activity

Third Quarter 2014 M&A Activity	2014 Q2	2014 Q3	Change	2013 Q2	2014 Q3	Change	2013 YTD	2014 YTD	Change
Home Health Care	25	22	-12%	27	22	-19%	67	74	10%
Hospice	9	5	-44%	7	5	-29%	22	24	9%
Staffing	10	12	20%	5	12	140%	8	31	288%
Home Medical Equipment	18	14	-22%	9	14	56%	40	47	18%
Pharmacy Services	4	14	250%	6	14	133%	17	29	71%
Behavior Health & Social Services	22	26	18%	11	26	136%	52	71	37%
Total	**88**	**93**	**6%**	**65**	**93**	**43%**	**206**	**276**	**34%**

Aggregate Behavioral Health & Social Services Deal Trends



Behavioral Health M&A Activity 2013 vs 2014

Behavioral Health M&A Activity 2013 vs 2014	2013 YTD	2014 YTD	Change
Intellectual & Developmental Disabilities	14	21	50%
Addictions and Substance Abuse	22	20	-9%
At Risk Youth	5	3	-40%
Mental Health	10	26	160%
Aquired Brain Injury	1	1	0%
Total Sector	**52**	**71**	**37%**

Why the Run Up?

As we foreshadowed several months ago in our *viewPOINTS* commentary, *"Are We In the Midst of an M&A Bubble?,"* numerous factors such as a record-breaking stock market, more than 2 trillion in idle private equity and corporate cash, a relatively benign reimbursement climate, a confidence building improving economy, and expectations of increased utilization driven by healthcare reform have converged to produce a climate ripe for extremely robust deal flow – and valuation.

Factors Driving M&A Volume And Valuation

Any one of these developments could create a spike in activity, but put them all together…you have a year of Black Fridays.

Outlook: What Will Bring It All Down?

Bubbles are fragile by nature. They rise fast – and often unexpectedly. And they deflate much the same way. Fast – and unexpectedly.

While we don't know the timing, we can guess the pressure points.

- A derailment of the stock market, possibly by external events – the middle-east, the Ukraine, domestic unrest, etc.

- A sudden and sustained reversal of the economic recovery, perhaps due to what many suggest is an inevitable rise in inflation and/or interest rates.

- A significant change in reimbursement policy. With substantial reimbursement coming from private insurance, private pay, and multiple waivers and other state funded programs, behavioral health is somewhat less exposed to across the board, "stroke-of-the-pen" cuts that can slice revenues from narrow service providers dependent on equally narrow Medicare and Medicaid reimbursement. But as in all of healthcare, the sector is susceptible to universal themes of cost containment, particularly as it relates migration of patients from out-of-network to in-network.

- Failure to deliver on the promise of healthcare reform, particularly parity initiatives. Right now, investors are giddy with the expectation of more covered beneficiaries and the increases in utilization (i.e. revenues) that come with it. But if the promise doesn't live up to the hype (as is quite possible given the number and interplay of all the moving parts that drive health care spending), a market that's fickle can quickly become a trickle.

But the Grinch won't steal Christmas this year.

We expect 2014 to close out in record-breaking fashion.

THE BRAFF GROUP DIFFERENCE

Since the firm's inception in 1998, we have closed more than 245 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 and for the six year period from 2008 through 2013. Four Time Winner Health Care Deal of the Year.

Call us to see how we can put our experience to work for you.

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