Behavioral health continues to attract private equity investors
by Deborah Balshem in Fort Lauderdale
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- Increased insurance coverage, reforms fueling growth
- Private equity eclipses strategics in 2016 deal volume
- Autism services among highly coveted sub-sectors

Favorable market trends continue to lure private equity and other investors to behavioral health deals.

The space remains a white hot market, particularly among PE firms, with increasing demand, good cash flow and margins, and government legislation driving M&A activity, according to three industry bankers.

“The same factors that have been lifting behavioral health for the last five years continue to move the market,” said McNeill Wester, managing director of healthcare investment bank Coker Capital.

Those tailwinds include expanded insurance coverage for behavioral health and substance abuse treatment, and legislative reforms such as the Patient Protection and Affordable Care Act, Medicare Improvements for Patients and Providers Act (MIPPA), and an updated Mental Health Parity and Addiction Equity Act, the latter of which puts mental health treatment on a reimbursement par with medical and surgical benefits.

MIPPA, which provides enhanced outreach and coverage to low-income Medicare beneficiaries, including those with disabilities and psychiatric conditions, was enacted in 2008 and received additional federal funding in 2010, 2013 and 2014.

The Affordable Care Act of 2010 allows children to stay on their parents’ health insurance until age 26 (up from age 18), providing “a big bump” to providers, given roughly 18% of people over the age of 18 are affected by behavioral health issues, Wester noted.

PE leads pack

In 2016, PE sponsors accounted for a record 73 transactions, 60% of all the deals completed in behavioral health care, according to Ted Jordan, managing director of The Braff Group, an M&A advisory firm focused on healthcare. Given 28 platform investments in 2015 (more than double the previous high of 11 recorded in 2013), add-on acquisitions in 2016 eclipsed last year’s record by almost 20%, he said.

And, although down a tick from 2015, the 24 new platform investments in 2016 were still well above the trendline between 2007 and 2014, Jordan noted.

There is a significant amount of interest in the highly fragmented space among PE firms, with some dipping down past their minimum threshold to gain a foothold in the more than USD 200bn sector, he added.

There are PE firms that typically do not invest in companies with sub-USD 10m in EBITDA that are now eyeing targets in the USD 3m-USD 4m EBITDA range, Wester said. Companies with less than USD 1m in EBITDA can still be attractive add-ons, if they fill a gap in care or geography, he pointed out.

The main strategic acquirers in the overall behavioral health space, according to the bankers, are **Acadia Healthcare Company** [NASDAQ:ACHC], **Universal Health Services** [NYSE:UHS] and **AAC Holdings** [NYSE:AAC]. In the intellectual and developmental disability (IDD) sector, Jordan mentioned **Civitas Solutions** [NYSE:CIVI] and **Onex**-backed **ResCare** as among the main players.

More recently acquired PE platforms in the behavioral health and addiction treatment space include **Kohlberg & Company**-backed **Alita Care, Audax Group**-backed **Meridian Behavioral Health, Goldman Sachs**-backed **Advanced Recovery Systems** and **Centre Partners**-backed **Bradford Health Services**.

The third banker noted addiction recovery services firm **Pyramid Healthcare**, held by **Clearview Capital** since 2011, as a logical near-term sale target. Pyramid has made at least seven add-on acquisitions under Clearview.

The banker also noted ResCare as a potential target, as it has been held by Onex since 2004. Last year, ResCare sold some of its Wisconsin home health holdings to **Almost Family** [NASDAQ:AFAM].

Investment criteria

Despite a modest drop off in the number of deals (mainly in the IDD sub-sector) last year, behavioral health in general continues to entice investors. Sub-sectors with particularly strong traction include drug and alcohol addiction, as well as autism, brain injury, at-risk youth and eating disorders, the bankers said.

Behavioral health issues are often accompanied by substance abuse problems, making for complicated cases that often require multiple stays in high-acuity residential treatment centers, as well as ongoing, long-term outpatient care, Wester explained.

Multiples in the space typically range from 7x EBITDA to 12x EBITDA or more, while EBITDA margins can vary widely, from 5% to 25%, according to the bankers, who noted autism services providers tend to have high margins.

When investing in a behavioral health company, payor dynamics is key, with in-network contracting commanding higher valuations from buyers, Wester said

Continuum of care is also important. Providers offering lower-cost outpatient treatment in addition to high-end residential treatment are generally seen as more attractive as they "get patients all along the way and pick up every dollar for those patients, from detox to residential treatment to sober living, while simultaneously meeting all of the clinical needs of their patients," Wester added.

Businesses that can successfully track clinical outcomes usually earn a premium valuation, continued Wester, who said those with a good management team and strong clinical reputation, which fosters a high-referral rate, are also seen as highly appealing.

Autism assets scarce

Autism services providers, which today are receiving reimbursement from multiple sources including commercial insurance, Medicaid and school districts, are highly sought after, yet there are few companies with enough scale to attract investors, according to Jordan.

With an estimated one in every 68 children born somewhere along the autism spectrum, demand is booming, and in terms of valuation, "the sky's the limit" for any autism service provider with enough scale to attract buyers, he added.

Last month, this news service reported that **Jefferson River Capital-**backed **Autism Learning Partners**, which is projecting USD 70m in revenue this year, was fielding sale interest. In May, Mergermarket reported that privately held **Autism Home Support Services**, which has roughly USD 20m in revenue, was in a Ziegler-led sale process.

Also this year, Mergermarket published reports on potential or expected M&A or fundraising by autism services providers including **The Center for Autism** and **Related Disorders**, **ChanceLight Behavioral Health** and **Education**, and **Capital Education Group**.