BRAFF

The leader in Autism Services Mergers & Acquisitions

INSIGHT INTO AUTISM M&A: A THREE PART SERIES

STRANGER THINGS

The Upside Down of Autism Mergers & Acquisitions

PART 3

In Autism, There Will be Fewer Follow-on Deals Completed by Private Equity Sponsors

Editor's note: this is the third of a three-part series on why Autism M&A has played out far differently than other health care services sectors.

All the data and analysis presented in this series has been drawn from a proprietary database developed by The Braff Group.

Follow-on vs. Platform Acquisitions

As illustrated in the chart below, the ratio of follow-on to platform transactions for all health care services excluding autism is 2.39. Said another way, for every platform investment, there have been 2.39 follow-on deals. However, when we examine autism, the ratio falls nearly 40% to 1.45. Owing to where we are in the consolidation cycle, the gap will close. But in the end, we will still see an appreciable difference.

Why?

One word.

Reverse arbitrage (OK, two).

It's been well documented that, driven in large part by demand exerted by private equity and availability of debt, valuations in autism services have risen to unprecedented levels. Double-digit multiples, typically reserved for companies with earnings in excess of $10 million have been bestowed to providers with as "little" as $1-2 million.

Now, typically, one of the primary strategies private equity sponsors use to build value is to capture size premium multiples.

Consider a $10M company with $2M in earnings, that garners a 6.0 multiple and a purchase price of $12M – quite reasonable for a modestly sized, but nevertheless attractive, health care services company. But if you put five of these together creating a consolidated entity with $50M in revenues and $10M in earnings, it might sell for a 10 multiple because of its size.

Now do the math.

In its most simple calculation, the buyer paid $60M for the five companies, but when combined, they can sell it for $100M and earn a cool 67% return. And that's before they capture any profit enhancing synergies. That's arbitrage. And it's like spinach to private equity's Popeye.

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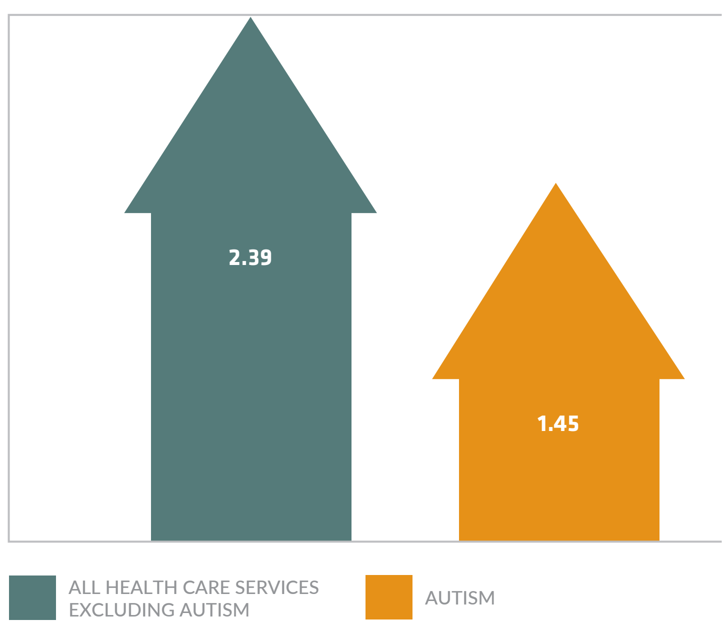
RATIO OF FOLLOW-ON TO PLATFORM TRANSACTIONS



STRANGER THINGS
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But what if the buyer's first five deals were in an extremely hot market, and they had to pay 10 times earnings to land them? While there would likely be some additional size premium that could be extracted upon the sale of the consolidated entity – say an exit at 13x – the return at $130M would be less than half the 67% in our first example. Now consider that many modest sized autism service providers have fetched multiples of 13x, 14x, 15x and higher. At such valuations, there is virtually no room for an additional size premium upon consolidation. In fact, it's quite plausible that the size adjusted exit multiple could be less than what was paid going in.

So, what's a buyer to do?

Reverse arbitrage.

That is, try and acquire future companies at substantially lower multiples. **Better yet, focus on start-ups that, if successful, can generate substantial returns on the initial investment.** By doing so, they can bring their blended investment multiple lower – leaving room to capture a size premium upon exit.

So, in autism services, with valuations still running high-ish, would-be buyers are eschewing follow-on deals in favor of de novo program openings, driving the follow-on to platform ratio down.

This, in turn, will cut into acquisition demand as the consolidation cycle matures.

THE BRAFF GROUP

We founded The Braff Group in 1998 with a simple goal in mind: to amass a body of sector-specific healthcare mergers and acquisitions experience, resources, and data to turn a good deal into a great one.

In Autism Services, we know the variables – and how to communicate them – to capture and emphasize our Clients' Value Proposition.

- From collecting and analyzing ASD specific data points to benchmarking their performance
- From experience with clinic-based, school-based, multi-disciplinary and in-home services to how they interplay to produce growth opportunities and competitive advantage
- From understanding the CPT codes to evaluating in-network, out-of-network, Medicaid, TRICARE, and school district reimbursement

The firm provides an array of sell-side only transaction advisory services including representation, debt and equity recapitalization, strategic planning, and valuation.

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