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INSIGHT INTO HEALTH CARE SERVICES MERGERS & ACQUISITIONS

THE BRAFF REPORT

COVID Has Spiked Investor Interest in Addiction and Mental Health

Should Providers Divest While It's Positively Giddy

It may be cliché to say timing is everything.

But in mergers and acquisitions, you under appreciate it at your own peril.

Consider this.

In appraising acquisition opportunities, buyers and sellers fixate on multiples.

We get it.

Multiples are the language of mergers and acquisitions success.

But here's the thing.

They are greatly influenced by collective assessments of where a market is headed. Assessments that exist in an echo chamber filled with buyers, sellers, market movers, and industry insiders, each reinforcing the other, creating an ever-escalating feedback loop.

And those assessments of which we speak?

Well, human nature being what it is, if they're favorable, we tend to misjudge them.

There's even a name for it.

Optimism Bias.

As explained by *Verywell Mind*,

> *We tend to be too optimistic for our own good. We overestimate the likelihood that good things will happen to us while underestimating the probability that negative events will impact our lives. [Moreover], this optimism bias is incredibly difficult to reduce.*

Two examples in behavioral health.

One that already happened, and more importantly, one that is happening as we speak (well, write, but you get the point).

One of the biggest reasons investors turned their attention to behavioral health was the passage of the Affordable Care Act in 2010 and the promise of increased utilization due to expanded requirements that insurers cover behavioral health treatment "on par" with medical treatment.

Almost immediately, acquisition demand began to surge, and with it, so did deal volume and valuations.

Now, their read of the opportunity was spot on.

The miss, however, was how slow insurers would be to fully implement these new guidelines. In fact, ten years later, many insurers are still pushing back against this initiative, earning themselves legal actions to force compliance. That said, other conditions that pushed behavioral health into the acquisition spotlight – increased demand due to the opioid epidemic, increased federal, state, and local funding, and reduced stigma attached to accessing these services – have more than offset any disappointment in how parity has played out.

Which brings us to where behavioral health stands today amidst COVID-19.

Consider the environment we are in.

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With the economy in free fall, would-be buyers, particularly private equity sponsors that need to get their capital deployed, are desperate to find something – anything – to acquire, lest 2020 becomes a complete washout.

Now consider that unlike so many business sectors that have been crushed by the epidemic, with all the emotional trauma and anxiety it has wrought, the market anticipates soaring demand for mental health and substance use disorder services.

Lastly, throw in added demand for any product or service that can be delivered remotely.

Put these developments together, the table is perfectly set for a frenzy in the making.

Like Black Friday shoppers trying to snatch up a 50-inch flat screen doorbuster, investors are trampling one another to gain a foothold in any behavioral health service you can put "tele" or "remote" in front of.

Although the frenzy is particularly, well, frenetic for tele-related behavioral health care services, it extends beyond them to residential and out-patient SUD and mental health programs, particularly high-volume, low-touch, medication assisted treatment.

Now, to be perfectly clear, we believe that buyers are reading the tea leaves, and hence the market opportunities therein, correctly.

But...

There's that pesky optimism bias at play.

Telepsychiatry is going to be big. But are there enough practitioners out there to be on the other side of the camera? How about reimbursement? It's certainly moving in the right direction, but will insurers that are already pushing back against parity laws embrace the increased need, access, and expense attendant to these services without even a smidge of push back?

How about mental health and SUD utilization? It may very well spike because of the pandemic. But how much? And for how long? And there's those profit-minded insurance companies again, who will instinctively want to go into whack-a-mole mode when these expenses inevitably become more visible.

From a mergers and acquisitions standpoint then, how does this affect the timing issue we opened up with?

Well, one only needs to look at the past to get a pretty good idea about what could happen in the future under similar circumstances. And in health care services, the past is replete with sectors that have gone all bubblicious on anticipated or early stage shifts in market dynamics, only to deflate when such unbridled optimism became bridled with an overestimate here, an unanticipated development there; a slight market shift here, a new investment distraction there.

Sector	Sound Expectations	Tempered Reality
Disease Management	DM companies arose and captured the market's attention when managed care 1.0 began to take root in the late 90s and the need to monitor and control utilization became acute.	Consumers and patients rejected overzealous efforts to control costs, which tarnished the managed care movement and, with it, the juice behind disease management.
Home Health Care	Policy initiatives to incentivize reductions in aggregate patient spend portended substantial increases in utilization and demand for best in class providers.	A pendulum swing to over-utilization, which drew punishing scrutiny from regulators, and commodity pricing by payors that failed to distinguish between providers, blunted expectations for increased revenues and profits.
Physician Practices 1.0	Physician practice consolidation enjoyed a brief time in the spotlight in the late 90s and early 2000s on the economic promise of market clout, contracting, and operational efficiencies.	This initial incarnation largely failed on reductions in physician productivity post-transaction and not-quite-ready-for-prime-time payor contracting, abruptly ending consolidation strategies in the space.
Urgent Care	Substantial increases in utilization from newly covered beneficiaries under the Affordable Care Act who lacked primary care physicians.	Rise in competition due to low barriers to entry, minimal consumer loyalty, and influx of hospital-owned programs that positioned urgent care as a loss-leader soured many private equity sponsors' interest in the sector.

So, what is the lesson to be learned from these all-too-common scenarios regarding timing in mergers and acquisitions?

Quite simply...

Market multiples peak when favorable risk-return fundamentals collide head-on with optimism bias - and slide when outsized expectations collide head-on with rightsized reality.

Moreover, even when markets behave exactly as one hopes, the returns - favorable as they might be - **bound** what was previously **unbounded optimism**.

As a result, quite often it's the sellers that identify and exploit this phenomenon of timing and expectations - the sellers that sell the promise - that often nail the timing and seize all too fleeting peak valuations.

So, if you're a mental health or SUD provider, can you make the argument that when you combine giddy market optimism with increased investment demand from buyers eager to get back into the game, that valuations may well be on their way to their peaks?

You bet.

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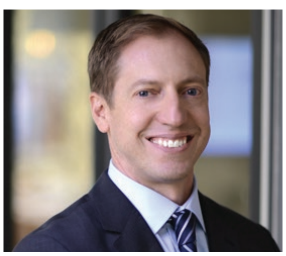

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20 YEARS & COUNTING

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