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The leader in Health Care Services Mergers & Acquisitions

INSIGHT INTO HEALTH CARE SERVICES MERGERS & ACQUISITIONS

THE BRAFF REPORT

Mid-Year 2020 Health Care Services M&A

The Data is In – and it's Tricky

In the annals of things that don't take a genius to figure out, wondering what the impact of COVID-19 on mergers and acquisitions activity ranks right up there with wondering if a Kardashian could survive without constant attention. (Uh, no?) So, is anyone surprised that, according to PitchBook, second quarter 2020 North American deal count across all sectors and sizes plunged 24.2% vs. Q1? Or that GF Resources reports that lower middle market deal count in the US fell 62%?

Did Health Care Services Dodge the COVID Decline?

It turns out, however, that things are not so obvious when it comes to health care services deal activity. You see, based upon proprietary data collected and analyzed by The Braff Group, aggregate transaction volume in these sectors fell only 6% in Q2.

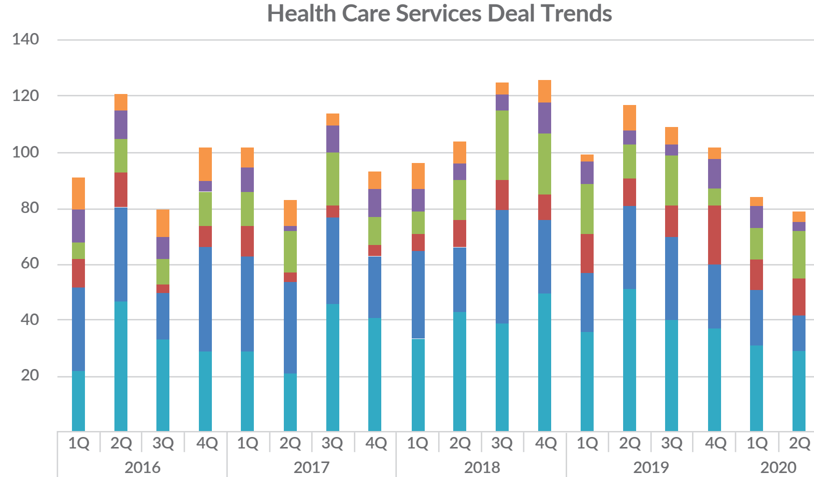
At first glance, this made about as much sense as why low dose aspirin is typically 81 mg (instead of, you know, 80).

So, we zoomed out on the data to see how it looked over a five-year period, and that view yielded some interesting observations.

From the graph below, it becomes apparent that the reason the fall-off in Q2 vs. Q1 was so modest, was **not** because Q2 wasn't low – it was. It was because Q1 was abnormally low. Although Q1 has historically been a light quarter, the 2020 version was the lowest we've seen in the past five years (and no, this is not because the past four Q1s have been trending down – they're modestly up).

> **"The reason the fall-off in Q2 vs. Q1 was so modest, was not because Q2 wasn't low – it was. It was because Q1 was abnormally low."**

Health Care Services Deal Trends



	2016				2017				2018				2019				2020	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q
Health Care Staffing	11	6	10	12	7	9	4	6	9	8	4	8	2	9	6	4	3	4
Pharmacy	12	10	8	4	18	2	10	10	8	6	6	11	8	5	4	11	8	3
Home Medical Equipment	6	12	9	12	7	15	19	10	8	14	25	22	18	12	18	16	11	17
Hospice	10	12	3	8	7	3	4	4	6	10	10	9	14	10	11	11	11	13
Home Health Care	30	34	17	37	34	33	31	22	32	23	41	26	21	30	30	23	20	13
Behavioral Health	22	47	33	29	29	21	46	41	33	43	39	50	36	51	40	37	31	29

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The Home Health Care Effect

So why was Q1 so low? While it takes some squinty-eyed sleuthing to tease this out, it appears that the culprit is home health. While Q1 2020 was only a deal shy of Q1 2019, it was down more than 30% vs. Q1 2016-2018. The fall-off is even more apparent when you revisit the chart above and see that the 13 deals in the 2nd quarter of this year was the lowest it's been over the period.

So, why is home health down so substantially? There must be something other than COVID at play.

And, in fact, there is.

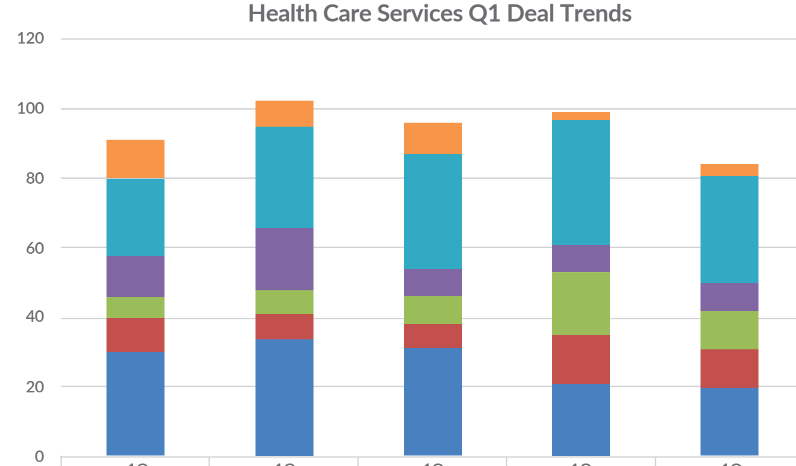
Now, while nobody likes an "I-told-you-so," we did just that way back in the fall of 2018.

In a Braff Group marketALERT publication entitled, *Home Care and Hospice M&A – New Strategies, New Buyers, and Changing Fortunes: The Magic Eye Knows*, in response to a radically new payment program for Medicare certified home health agencies expected to go into effect on January 1, 2020, we said,

"...[M]uch like we saw when the prospective payment system was initiated, the market for home health agencies could very well be on ice for a year (or more) beginning July 1, 2019."

> **"So why was Q1 so low? While it takes some squinty-eyed sleuthing to tease this out, it appears that the culprit is home health."**

Health Care Services Q1 Deal Trends



	1Q 2016	1Q 2017	1Q 2018	1Q 2019	1Q 2020
Health Care Staffing	11	7	9	2	3
Behavioral Health	22	29	33	36	31
Pharmacy	12	18	8	8	8
Home Medical Equipment	6	7	8	18	11
Hospice	10	7	6	14	11
Home Health Care	30	34	32	21	20

Mixed Results for Behavioral Health

That development explained, we turned our attention to another data set that seemed odd to us. In light of expectations for increased demand, utilization, and funding for behavioral health services due to the stress caused by the pandemic, we anticipated that M&A activity in behavioral health might withstand the COVID plunge, and even grow.

But a look at the graph above shows that while BH activity didn't fall off a cliff, it did, in fact, fall.

To find out why, we zoomed in on the sector to see what we could learn.

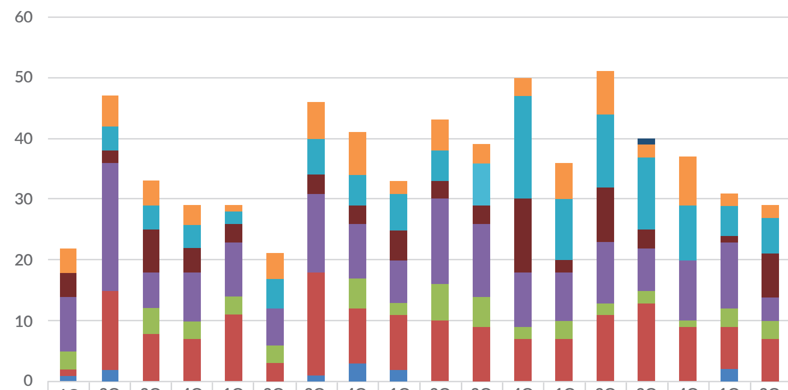
As can happen in a sector with multiple, largely independent sub-segments, an aggregate view can be misleading. Case in point: a close examination of the sector reveals that medication assisted treatment M&A activity surged in Q2, while mental health deal flow remained relatively stable.

These results, however, were hidden due to substantial fall-offs in (a) autism services transactions (which had become the big dog in behavioral health M&A), and (b) residential and non-residential substance use disorder programs (SUD) .

The fall-off in autism was expected, as clinic-based programs essentially shut down when much of the country went into lockdown. What was somewhat surprising was the drop in residential and non-residential SUD. Given the deals that we currently have under letter of intent, and the conversations we are having with buyers, this decline might simply be an anomaly.

[While aggregate behavioral health deal volume was down in Q2,] "...a close examination of the sector reveals that medication assisted treatment M&A activity surged."

Behavioral Health Deal Trends



	2016 1Q	2016 2Q	2016 3Q	2016 4Q	2017 1Q	2017 2Q	2017 3Q	2017 4Q	2018 1Q	2018 2Q	2018 3Q	2018 4Q	2019 1Q	2019 2Q	2019 3Q	2019 4Q	2020 1Q	2020 2Q
Unidentified	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0
IDD	4	5	4	3	1	4	6	7	2	5	3	3	6	7	2	8	2	2
Autism	0	4	4	4	2	5	6	5	6	5	7	17	10	12	12	9	5	6
SUD: Medication Assisted Treatment	4	2	7	4	3	0	3	3	5	3	3	12	2	9	3	0	1	7
SUD: Residential and Non Res.	9	21	6	8	9	6	13	9	7	14	12	9	8	10	7	10	11	4
At Risk Youth	3	0	4	3	3	3	5	5	2	6	5	2	3	2	2	1	3	3
Mental Health	1	13	8	7	11	3	12	9	9	10	9	7	7	11	13	9	7	7
Acquired Brain Injury	1	2	0	0	0	0	1	3	2	0	0	0	0	0	0	0	2	0

Expectations for the Second Half of 2020

With pent-up acquisition demand and much of the country relaxing their lockdown orders, we expect that M&A activity across the broad market will rise over Q3-Q4.

Gains in Behavioral Health

We expect the biggest gains overall in behavioral health, not only due to the continued interest in medication assisted treatment and mental health, but (a) a rise in autism deals as many providers have rebounded from their census declines, and (b) a correction to what we believe is an anomaly in residential and non-residential SUD transactions.

"With pent-up acquisition demand and much of the country relaxing their lockdown orders, we expect that M&A activity across the broad market will rise over Q3-Q4."

Strong Activity in Hospice

If you return to the Heath Care Services graph above, you'll see that two other sectors have dodged the decline – hospice and home medical equipment. In hospice, while skilled nursing and other congregate living facilities have restricted access to providers which has temporarily curtailed utiliza-tion, acquisition demand has not abated. Moreover, we've documented that when home health deal flow is down, hospice tends to go up (marketAlert: *Acquisition Interest Flip Flops Back to Hospice - But History Tell us it Won't Last for Long*). So, at least over the near term, we anticipate sustained and strong hospice deal activity.

A Rebound in Home Health?

As the market settles into a new reimbursement methodology, buyers that have been largely sidelined for 6-12 months may begin returning to home health. In part, this is because of home health's enviable position as a primary catalyst to lower costs and increase profits in emerging global payment models.

Home Medical Equipment Ambles On

Again, if you return to the first graph above, you'll see that, in terms of M&A activity, HME has thus far held up under the disruption of the pandemic. We expect this trend to continue as buyers, particularly those with private equity sponsors, continue to view the sector as (a) largely insulated from substantial go-forward cuts in reimbursement, and (b) positioned well to take advantage of a "last man standing" consolidation play.

For further insight and details regarding go-forward expectations, see *The Braff Report: Health Care M&A in the Time of COVID-19 - Sectors that will Fare Better than Others*.

So, all things considered, if a safe vaccine is available by the end of Q1 2021 - unleashing the economy, freeing up capital, and jumpstarting stalled consolidation strategies - 2021 could easily be a banner year for health care services M&A. What's more, political preferences aside, with policies that generally favor increased access to care, a Biden win could potentially add to this resurgence.

Anything to erase the memory of 2020.

20 YEARS & COUNTING

The Braff Group is the leading mergers and acquisitions advisory firm specializing exclusively in health care services, including behavioral health, digital health, home health and hospice, pharmacy services, urgent care, health care staffing, home medical equipment and ancillary health care services. The firm provides an array of sell-side only transaction advisory services including representation, debt and equity recapitalization, strategic planning, and valuation. Founded in 1998, The Braff Group has completed more than 340 transactions. According to Refinitiv, The Braff Group has repeatedly been ranked among the top 5 health care mergers & acquisitions advisory firms.

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