Dexter Braff
President
The Braff Group

In this Voices interview, Behavioral Health Business sits down with Dexter Braff, president of The Braff Group, to learn about the top behavioral health M&A trends and market segments to watch in 2023 and beyond. He discusses the impact that economic uncertainty, inflation and rising interest rates will have on deal flow and valuation in this space for years to come, and he also shares insight into the evolving consolidation strategies that will shape the industry moving forward.

Editor’s note: This interview has been edited for length and clarity.

The Braff Group is a mergers and acquisitions advisory firm specializing exclusively in health care services including behavioral health, home health, home care and hospice, health care staffing services, home medical equipment, pharmacy services and ancillary health care services. To learn more, visit thebraffgroup.com/market-sectors/behavioral-health/.

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In forming The Braff Group, we played the long game and ran the business with patience, which was foundational in shaping the organization as it stands today. Taking time to develop the infrastructure and culture necessary to support an organization that would last is a process that requires immense patience, and I think we bring the very same approach to deals. It’s crucial that we don’t rush things. It’s crucial that we build a strong foundation for supporting deals and making them work. And that patience enables us to surface the best transactions available to our clients. My experiences as an entrepreneur have played a key role in shaping those traits.

It’s been a remarkable time for the mental health component of behavioral health. Psychiatric hospitals, to some degree, and multi-site mental health clinics, to a greater degree, have seen tremendous growth. It’s literally a function of the pandemic. Mental health transactions were rising with the growth of behavioral health and in 2020, the numbers spiked dramatically with no sign of slowing down.”

Again, the demand overpowers the downward pressure. One of the things we are seeing is that if labor costs go up, which they have, income goes down. If income goes down, that can eat up some of the valuation, even if buyers ascribe the same or higher multiples of earnings as the basis of their valuation. Deal flow and valuation may begin to level off for the first time if sellers are not able to offset increased costs, particularly in staffing. As a result, they might hold off for a little while because their earnings will not be as attractive as they were prior to the increase.

I would be overly optimistic to say that despite the high level of interest in the space, these extraordinary economic pressures won’t have an impact. At the end of the day, I think that whatever we see in the behavioral health space is likely going to be less than what we’re seeing in the markets overall.
Q: Behavioral Health Business: At the Behavioral Health Business INVEST Conference in Chicago this October, you provided a complete rundown of where things currently stand in behavioral health M&A. Can you give us a quick snapshot of where we are compared to 2021?

Braff: The behavioral health M&A trendline has been steady at a nearly 45-degree angle since 2013. But 2021 created an interesting dynamic because it was such an extraordinary year. The number of deals that were completed in 2021, not only in behavioral health care but in all health care services nationwide, was so much greater than the previous record for a variety of different reasons.

Comparing 2022 to 2021 is almost unfair because it would be highly unusual if a sector was able to keep up with the pace of 2021. When we look at the numbers through the third quarter, I think measuring against 2020 is most instructive.

Based on the results through the end of the third quarter, we’re running about 24% behind the record output generated in 2021 in behavioral health care. However, we’re running about 5% ahead of the 2020 record. You have to zoom out to get the complete picture of where we stand in 2022 because the numbers aren’t bad, they are just low compared to the ridiculously strong year we had in 2021. Things will continue to go well in the behavioral health care space.

All of our numbers are based on a proprietary database that we’ve been building since 2001. We have more than 20 years’ worth of data that goes beyond what most people read about, because much of what’s out there is aggregated from public announcements made by publicly-traded companies. Our data obviously includes all of that, but because we’re so active in the space, we also have insight into transactions that were not necessarily announced. Additionally, we conduct exhaustive searches of literature every quarter in order to find transactions that may have been literally announced in a local newspaper.

It’s a lengthy process. It’s an expensive process, but it is a process in which we feel very good about investing. It helps us not only from a marketing standpoint, but also with identifying and understanding trends before our competitors.
Q: **Behavioral Health Business:** What has changed most over the past 12 to 24 months in terms of acquisition interests? Which segments are heating up or slowing down, and why?

**Braff:** It’s been a remarkable time for the mental health component of behavioral health. Psychiatric hospitals, to some degree, and multi-site mental health clinics, to a greater degree, have seen tremendous growth. It’s literally a function of the pandemic. Mental health transactions were rising with the growth of behavioral health and in 2020, the numbers spiked dramatically with no sign of slowing down.

The spike is absolutely attributable to the fact that investors and strategic players in the space were able to read the tea leaves during the pandemic and recognize the need for mental health services amidst the exacerbated stress of the pandemic. That continues today — not necessarily the stress of the pandemic — but people are beginning to feel the impact of what happened in 2020 and 2021.

The collective wisdom was that the space was poised to explode in demand, which created extraordinary interest. Right now, the mental health segment is the fastest growing from a mergers and acquisitions perspective. On the other side of the coin, acquisition activity for high-end residential substance use disorder treatment did not see much of a turnaround, but we knew this was going to happen.

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We’ve been predicting it for a while, and it has been happening over the past five years or so. The expensive boutique model of residential care is just not a favorable treatment setting right now. There’s very little acquisition interest in that space, especially when considering that it was one of the first areas consolidated in addiction treatment. It was really hot for a while, but that deal flow has slowed to a trickle today.
Q: Behavioral Health Business: How might rising interest rates impact the deal flow and valuation in this space?

Braff: As everyone knows, the Fed has been increasing the funds rate steadily over the past year. More than 50% of the transactions in behavioral health are funded by private equity sponsors, generally with 50% debt and 50% equity coming from their limited partners.

If the cost of debt goes up, which it is, then the amount of debt that the private equity groups can deploy while still generating their target returns gets constrained. Those returns have to be made up with more equity or, if you keep the balance of 50/50, it means the overall valuations will drop.

This is not a behavioral health issue. This is an M&A issue. If you put in more equity, the return on investment of PE funds becomes more difficult to achieve. There is definitely pressure on valuations because of the increased cost of debt.

That said, the interest and demand for high quality players within the behavioral health space continue to be so great that the demand for those companies overshadows the marketplace challenges. As of yet, we have not seen substantial pricing reductions as a result of the interest rate challenges.

From a consolidation standpoint, we’re seeing organizations build models around home-based physician visits where these providers are accessing other types of services to treat the patient holistically. That means they are partnering with home health companies, behavioral health companies and home medical equipment companies in order to provide the full suite of care in the home. The tentacles of this movement reach into many different facets of the health care delivery system.”

Two years ago, we might have had four or five offers at breakout valuations. Now, we may only see one or two, with the other three feeling more constrained due to the cost of capital. Opportunistically, the market continues to support high valuations when a quality seller is matched with one or two buyers that really want a particular asset.
Q: Behavioral Health Business: What is the most interesting development you’ve seen in terms of evolving consolidation strategies?

Braff: The proliferation of addiction treatment and mental health services in the home-based setting has been remarkable, particularly in the addiction space, where there really weren’t many home-based programs previously. We did an analysis of companies that offer addiction treatment programs where the patient/client is at home receiving care. The number of companies offering that right now is about 50. That didn’t even exist to any large degree two years ago.

Through the marrying of technology, telehealth and the home becoming a preferred care setting, we are seeing a greater variety of treatment options in the home that were not even thought about in years past. Home-based addiction treatment and mental health is where the market is moving. It doesn’t mean that everybody’s going to be in that space, or that there’s no room for a community-based structure, but this new segment is extremely attractive to investors and customers alike.

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Q: Behavioral Health Business: Finish this sentence: The top strategy that care providers should employ in 2022 to best prepare for 2023 is…?

“Piloting or participating in a global payment, capitated payment or value-based purchasing approach.”