Duff & Phelps

Industry Insights:

Behavioral Health

By the Numbers

40 behavioral health transactions were announced in the first three quarters of 2015 as compared to 31 in 2014.

68% of transactions targeted in-patient behavioral health centers.

There are approximately 14,000 for-profit behavioral health and substance abuse facilities in the U.S., with an estimated average revenue per facility of approximately $1 million.

Highlights

Large for-profit strategic acquirers and financial buyers with existing platforms are capitalizing on industry fragmentation, leading to consolidation.

Legislation will continue to impact reimbursement and drive activity in the sector.

Integration of behavioral health solutions and medical delivery will fuel both provider partnerships and acquisition activity.

Positive social attitudes towards mental health, addiction and eating disorders have increased the demand for treatment.

Feature Story: Integration of Behavioral Health with Traditional Care is Driving Consolidation Within the Industry

Recent tragedies linked to mental health, including high-profile shootings and the crash of the Germanwings flight in March 2015, have drawn attention to the diagnosis and treatment of behavioral health illnesses. As costs within the healthcare system continue to rise, large healthcare systems are integrating across the continuum of care to control costs. The behavioral health industry, once made up of small practitioner groups is likely to see the emergence of large, super-regional providers in partnership with or owned by larger not-for-profit or for-profit integrated care networks. With behavioral health issues now at the forefront of medical care combined with strong macro healthcare tailwinds, we expect strategic and financial investors to become more active.

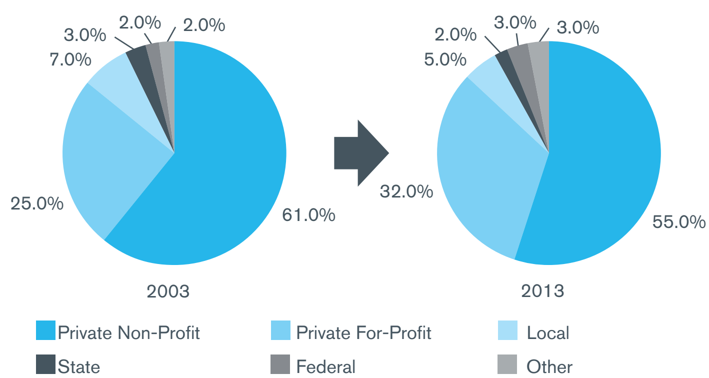
Insurance companies seeking compliance with legislative changes are influencing industry consolidation

The behavioral health industry has benefited from several pieces of legislation intended to increase access to mental health services in the U.S. and equalize insurance reimbursement for mental health care as compared to other medical and surgical care. The passage of the Mental Health Parity and Addiction Equity Act ("MHPAEA") in 2008 and the passage of the Affordable Care Act ("ACA") in 2010 are expected to increase spending on mental health related treatments. Another important piece of legislation passed in 2008 is the Medicare Improvements for Patient and Providers Act ("MIPPA"), which is designed to improve access to mental health services for federally funded programs. While implementation and regulation of the MHPAEA has been complex, all applicable health plans were to comply by July 1, 2014, making the effective date for most health plans January 1, 2015. In order to comply with the legislation, insurance carriers will seek providers capable of providing in-network behavioral health coverage, which may lead to the emergence of larger mental healthcare groups designed to meet the carrier demand.

Large, highly fragmented sector with a growing percentage of for-profit providers

The behavioral health sector is consolidating as a growing number of large for-profit strategic acquirers and financial buyers are capitalizing on significant industry fragmentation. According to the Substance Abuse and Mental Health Services Administration ("SAMHSA"), the industry contains more than 14,000 for-profit behavioral health and substance abuse facilities in the U.S., with the estimated average revenue per facility of approximately $1 million. The small size of most providers presents the opportunity for roll-up strategies where scale is likely to provide margin benefits.

Facility Operators by Owner Type



Source: Substance Abuse and Mental Health Services Administration

We expect consolidation to continue as pressure on local and state budgets increases, privatization of behavioral healthcare services grows, and facilities seek economies of scale as subsidies wane. According to the most recent data from SAMHSA, the number of for-profit organizations has increased from 25.0% of facility operators in 2003 to 32.0% in 2013. The number of patients treated by for-profit facilities increased by 53% during the same time period, from over 282K to more than 430K.

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Feature Story: Integration of Behavioral Health with Traditional Care is Driving Consolidation Within the Industry (cont'd)

Behavioral health integration is viewed as a key to cost containment

The increased use of behavioral health treatment not only lowers the cost of care, but also provides preventative health measures that improve health outcomes for patients long-term. As value-based healthcare models become more widespread and reimbursement becomes increasingly tied to patient outcomes, insurance companies and healthcare providers are looking to behavioral health treatments, in concert with physical treatments, to reduce hospital readmissions and overall costs.

With the high cost of emergency room visits, integrated behavioral healthcare can make a significant impact on the healthcare system as a whole. According to the National Health Council, it is estimated that 157 million Americans by 2020 will suffer from a chronic disease and that one in three of these individuals will experience symptoms of depression. Furthermore, 57% of Americans with a behavioral health illness or disease also suffer from a comorbid physical health condition. For example, if a patient recovering from surgery adheres to his/her ongoing medication regimen or a patient suffering from depression follows his/her mental health treatments, the likelihood of an emergency room visit or serious health complication is likely reduced. As a result, the integration of behavioral health solutions and medical delivery will fuel both provider partnerships and acquisition activity.

Increased awareness and acceptance of behavioral health issues

There is a growing social acceptance of those seeking treatment for behavioral health disorders and a rising awareness of the importance of behavioral therapy. Demand for behavioral health treatment has substantially increased partly due to these changes in social attitudes concerning patients seeking treatment and advanced recognition of disorders. Societal acceptance of mental disorders encourages individuals to seek early treatment and, therefore, prevents potential mental illnesses from developing. Better recognition and diagnosis of conditions, such as autism in children, has led to a growing population of mental health patients. According to the National Center for Children in Poverty, approximately 20% of adolescents have a diagnosable mental health disorder, which makes mental health one of the leading causes of disability for this demographic. The increased social acceptance of mental health disorders leads to increased utilization of mental health services. The growing demand provides organic growth opportunities, which further paves the way for the integration of mental health services into the continuum of care for large multi-service delivery networks.

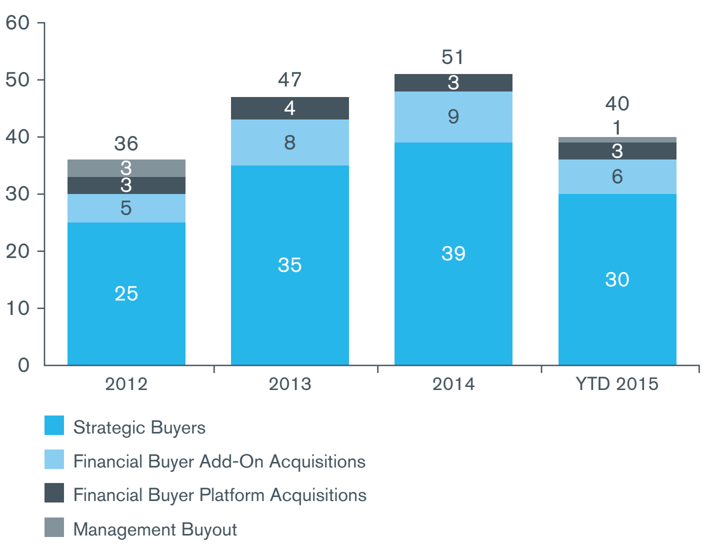
Favorable supply and demand dynamics within the industry will continue to drive growth

Proximity to facilities and a shortage of mental health professionals creates critical patient obstacles. According to the U.S. Department of Health and Human Services, in 2013, 38% of adults in the U.S. lived in communities with shortages of mental health professionals. More specifically, between 2003 and 2013, the number of facilities grew only 3.9%, while patients in treatment grew 14.4% during the same time period. Moreover, in 2012, 55% of U.S. counties had no practicing psychiatrists, psychologists or social workers. As the demand for integrated behavioral health services rises, it will likely fuel organic and new facility growth. Behavioral health providers with the ability to reach insured populations in areas with few mental health providers will have significant leverage in negotiations with insurance carriers. The industry will likely leverage telehealth technology, also fueling growth and provider utilization.

M&A Activity 2015

Forty behavioral health transactions were announced in the first three calendar quarters of 2015, putting the sector on track to outpace the prior two years. Activity continues to be driven by the increased awareness of mental health and substance abuse, growing acceptance of diagnosis and treatment of mental health illnesses and improved insurance coverage with the passage of the MHPAEA and ACA. Strategic buyers represent 75% of the announced transactions. However, financial buyer add-on acquisitions comprise a larger percentage of total year-over-year deal volume.

Facility Operators by Owner Type

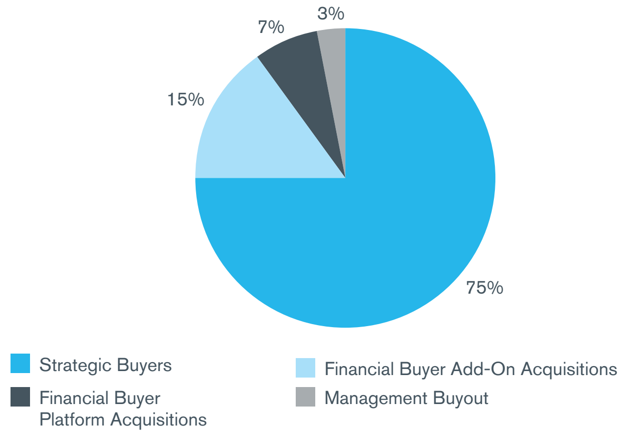


Source: S&P Capital IQ, Health Care M&A News

Behavioral health M&A activity remains strong

Given the industry's growth prospects, new telehealth technologies and recent legislation, the sector is primed for continued consolidation. According to Levin Associates, over 170 behavioral health transactions have been completed from January 1, 2012 through the end of fiscal Q3 2015. The majority of these acquisitions, 68%, targeted in-patient behavioral health centers. These facilities cater to higher-acuity mental health concerns, substance abuse and rehabilitation.

YTD Q3 2015 Transactions by Acquirer Type



Source: S&P Capital IQ, Health Care M&A News

The outpatient behavioral health sector is also subject to increased acquisition activity. While private equity-based roll-ups of smaller providers stand to gain from economies of scale, strategic acquisitions have been fueling transaction volume with over 100 acquisitions in the last five years. As strategic acquirers look to provide larger networks to insurance carriers, expand their geographic footprint and increase market share, we expect the industry to benefit from rising transaction volumes and significant long-term growth opportunities.

M&A Activity – Trends

M&A Case Study – Acadia Healthcare Company, Inc. (NasdaqGS:ACHC)

Acadia Healthcare Company, Inc. ("Acadia") is one of the largest providers of inpatient and outpatient healthcare services, operating a network of 76 behavioral healthcare facilities with approximately 5,800 licensed beds in 24 states, the United Kingdom and Puerto Rico. Since 2012, Acadia has executed an aggressive consolidation effort, purchasing 25 behavioral health and substance abuse treatment companies.

Acadia's most significant transaction to date is its $1.2 billion acquisition of CRC Health Group in February 2015. At the time of the acquisition, CRC Health operated 36 inpatient facilities with approximately 2,400 beds and 84 comprehensive treatment centers, which together served over 40,000 patients a day. In announcing the transaction, Joey Jacobs, Acadia Chairman and CEO stated, "CRC will diversify our payers, our services and our geographic concentration. With drug rehab being one of the most fragmented segments of the behavioral health care industry, we expect to expand CRC's business through acquisition."

Acadia is also actively expanding internationally. In July 2014, Acadia acquired Partnerships in Care, the second largest independent provider of secure and rehabilitation mental healthcare facilities in the UK, operating more than 1,200 beds across 23 hospitals. Acadia continues to expand its UK presence with Partnerships in Care's May and June 2015 acquisitions of Care UK's mental and behavioral health operations. In August 2015, Acadia announced the acquisition of six UK facilities, adding nearly 700 beds to Partnerships in Care's operations.

Acadia plans to continue its acquisitive efforts. Scott Brittain, an Acadia spokesman, recently stated, "[The behavioral health industry] is still a fragmented industry with a lot of single-facility operators out there. Each new patient that comes through will provide some level of incremental margin improvement."

M&A Case Study – Pyramid Healthcare, Inc.

On July 1, 2011, Clearview Capital ("Clearview"), a private equity firm based in Greenwich, CT, acquired Pyramid Healthcare, Inc. ("Pyramid"). At the time of the acquisition, Pyramid provided mental health and substance abuse treatment via 21 treatment facilities throughout Pennsylvania. Today Pyramid is now one of the largest providers of behavioral healthcare in Pennsylvania and New Jersey. Pyramid operates 64 residential and outpatient rehabilitation facilities across Pennsylvania, New Jersey and North Carolina.

Since acquiring Pyramid, Clearview has engaged in four platform add-on acquisitions. In May 2012, Clearview sought its first add-on acquisition with the purchase of October Road, Inc., a provider of outpatient mental health and substance abuse services in North Carolina. In October 2012, Clearview acquired American Day CD Centers, a provider of outpatient substance abuse and mental illness treatment programs in New Jersey. In May 2014, Clearview acquired Onward Behavioral Health, Inc. an outpatient substance abuse treatment provider in Pennsylvania. In October 2014, Clearview acquired Today Inc., an outpatient substance abuse treatment center based in Pennsylvania.

In announcing these transactions, James Andersen, Managing Partner of Clearview Capital, stated, "Pyramid has really developed into a powerful platform in the highly fragmented behavioral health industry. With nationwide demand for behavioral health services continuing to outstrip supply, Pyramid has numerous levers for continued growth and we plan to remain aggressive with new center openings as well as acquisitions."

M&A Case Study – Springstone, Inc.

On November 2, 2010, Welsh, Carson, Anderson & Stowe ("Welsh Carson"), one of the largest private equity investors in healthcare and information and business services, provided a $100 million equity investment in Springstone, Inc. ("Springstone") for the new development of behavioral healthcare and psychiatric hospitals.

Springstone focuses on building hospitals in communities that lack adequate numbers of treatment facilities and mental health professionals to meet the need. Springstone currently operates twelve highly specialized care – both inpatient and outpatient – facilities focusing on mental health issues and drug and alcohol dependency across the United States.

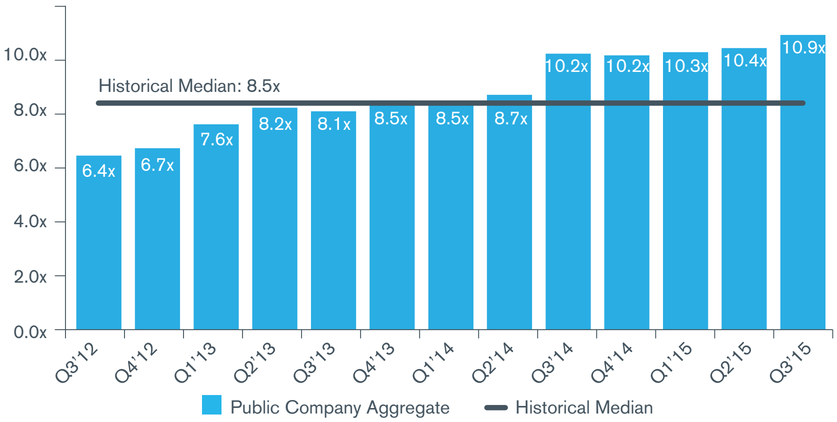
In commenting on Welsh Carson's equity investment, Jill Force, Chief Administrative Officer for Springstone, stated, "[Springstone] is looking to build behavioral health and psychiatric hospitals, but will consider acquisitions. Our emphasis is on organic growth from the ground up, however, we will definitely be looking at other development opportunities as they become available to us."

IPO Case Study – American Addiction Centers, Inc. (NYSE: AAC)

American Addiction Centers, Inc. ("AAC"), a subsidiary of AAC Holdings, Inc. (NYSE: AAC), is a leading provider of inpatient substance abuse treatment services. AAC operates 16 substance abuse treatment facilities and one mental health facility specializing in binge eating disorders located throughout the United States. AAC raised $75 million in a deal priced on October 1, 2014 at $15.00 a share, slightly above the $12.00 to $14.00 range. Over the past year AAC has traded between $15.00 and $44.75 per share. As of September 30, 2015, AAC is trading at $22.25 at EV/EBITDA and EV/Revenue multiples of 19.4x and 3.6x, respectively.

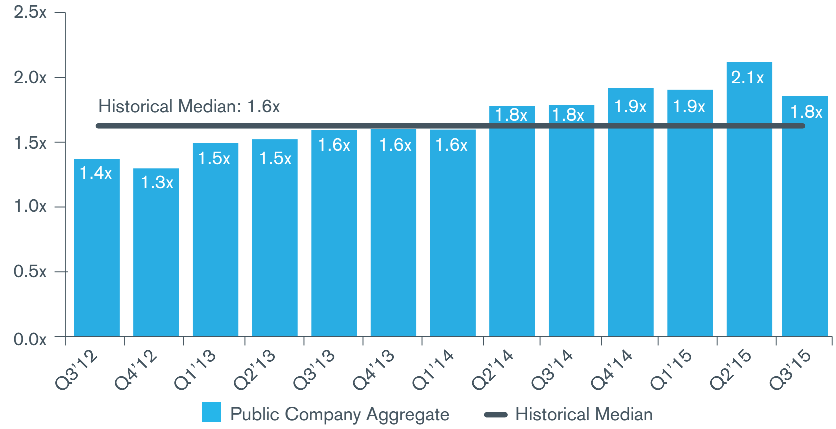
Behavioral Health Index Quarterly Multiples

Behavioral Health Index Quarterly LTM EBITDA Multiples (Q3 2012 - Q3 2015)



(1) EBITDA multiples greater than 100.0x are deemed not meaningful.
(2) Multiples calculated based on the average daily LTM EBITDA multiple for the preceding fiscal quarter. As such the multiples presented herein differ from the multiples presented elsewhere in this report.
Source: Capital IQ

Behavioral Health Index Quarterly LTM Revenue Multiples (Q3 2012 - Q3 2015)



(1) EBITDA multiples greater than 100.0x are deemed not meaningful.
(2) Multiples calculated based on the average daily LTM EBITDA multiple for the preceding fiscal quarter. As such the multiples presented herein differ from the multiples presented elsewhere in this report.
Source: Capital IQ

Notable Strategic M&A Activity

Date Announced	Target	Target Country	Acquirer	Target Business Description
Dec-15	Medical Management Options, Inc.	United States	Acadia Healthcare Company, Inc.	Behavioral healthcare services, including inpatient psychiatric services
Nov-15	AdvoServ, Inc.	United States	Wellspring Capital Management LLC	Behavioral health and transitional programming services
Oct-15	MedMark Services, Inc.	United States	Addiction Research and Treatment, Inc.	Substance abuse and addiction treatment
Oct-15	Start Fresh Private Management, Inc.	United States	MyLife Recovery Centers, Inc.	Substance abuse and addiction treatment
Sep-15	Foundations Recovery Network, LLC	United States	Universal Health Services Inc.	Behavioral health and substance use disorder treatment
Aug-15	Alpha Hospitals Limited	United Kingdom	Cygnet Health Care Limited	Behavioral health care facilities providing psychiatric care services
May-15	The Oxford Centre, Inc.	United States	American Addiction Centers, Inc.	Substance abuse and addiction treatment
May-15	Care UK Limited, Mental Health Services	United Kingdom	Partnerships in Care Limited	Network of treatment centers providing behavioral health treatment
Apr-15	Pastoral Care Group	United Kingdom	Acadia Healthcare Company, Inc.	Supported living facilities providing specialized behavioral health services
Apr-15	St. Louis Regional Psychiatric Stabilization Center	United States	BJC Health System, Inc.	Acute psychiatric inpatient behavioral health center
Mar-15	Sunrise House Foundation, Inc.	United States	American Addiction Centers, Inc.	Rehabilitation, substance abuse and addiction treatment
Dec-14	Hanley Center, Inc.	United States	Origins Behavioral Healthcare, LLC	Addiction recovery center
Dec-14	Belmont Center For Comprehensive Treatment	United States	Acadia Healthcare Company, Inc.	Behavioral health care facilities providing psychiatric care services
Oct-14	CRC Health Group, Inc.	United States	Acadia Healthcare Company, Inc.	Network of treatment centers providing behavioral health treatment
Sep-14	Cygnet Health Care Limited	United Kingdom	Universal Health Services Inc.	Behavioral health and social care services
Jun-14	Partnerships in Care Limited	United Kingdom	Acadia Healthcare Company, Inc.	behavioral health and psychiatric services
Apr-14	Psychiatric Institute of Washington, D.C., Inc. And Arbor Group, L.L.C.	United States	Universal Health Services Inc.	Behavioral health care facility and outpatient treatment center
Jan-14	Riverside Center for Behavioral Medicine	United States	Acadia Healthcare Company, Inc.	Acute psychiatric and substance abuse treatment
Jan-14	Highline Medical Center, Acute Inpatient Psychiatric Facility	United States	Acadia Healthcare Company, Inc.	Acute inpatient psychiatric treatment

Notable Financial Sponsor Investments

Investment Date	Ownership	Portfolio Company	Target Business Description
Dec-15 Nov-15	Audax Group, Inc.	Meridian Behavioral Health LLC; Centric Health Rehabilitation Inc.	Network of treatment centers providing chemical and behavioral health treatment Cognitive behavioral and physiotherapy services
Dec-15	Crestview Capital Funds	Sherman Consulting, LLC	Operates outpatient behavioral health facilities
Aug-15	Levine Leichtman Capital Partners	Monte Nido & Affiliates	Residential treatment programs for eating disorders
Jul-15	New Harbor Capital	Community Psychiatry	Outpatient behavioral health services
Jan-15	Revelstoke Capital Partners	Crossroads Holding	Outpatient medication-assisted treatment services
Aug-14	Duke Street; Tikehau Capital	Voyage Healthcare Group	Mental health and substance abuse treatment services
Jan-14	Pharos Capital Group	Seaside Healthcare	Dual diagnosis treatment for depressive, anxiety and personality disorders
Sep-13	Bregal Partners	US Community Behavioral	Community-based residential and behavioral treatment services
May-13	EDG Partners	Unity Physician Partners	Behavioral healthcare and primary care services
Jan-13	Lee Equity Partners	Eating Recovery Center	Eating disorder recovery centers
Mar-14 Dec-12	Trinity Hunt Partners	Family Help & Wellness; Lakeview Health	Medical, psychiatric and psychosocial treatments; Residential eating disorder treatment centers
Apr-12	H.I.G. Growth Partners	South Bay Mental Health Center	Outpatient mental health and substance abuse treatment services
Dec-11	Cressey & Company	InnerChange	Treatment programs for adolescents experiencing behavioral difficulties
Sep-11	Frontenac Company	Behavioral Health Group	Opioid addiction treatment services
Sep-11	Clearview Capital	Pyramid Healthcare	Drug and alcohol rehabilitation and behavioral healthcare services
Nov-10	Welsh, Carson, Anderson & Stowe	Springstone	Mental illness and addiction treatment services
Aug-10	Onex Partners	ResCare	Residential services segment offers disability and mental health treatment services
Aug-10	Webster Capital	Epic Health Services	Services include behavioral health, skilled nursing, personal care and adult therapy
Jan-08	Frazier Healthcare Partners; New Enterprise Associates	Elements Behavioral Health	Mental health disorder treatment centers

Related Case Studies

Sell Side Advisor

Community Psychiatry

has been acquired by

NEW HARBOR CAPITAL

Client

Community Psychiatry operates more than 20 regional outpatient psychiatry clinics and employs more than 40 psychiatrists. The company provides psychiatric care to children, adolescents and adults and offers a variety of psychiatry services including initial diagnoses and follow-up sessions, medication management, wellness programs and tele-psychiatry. As a result of the company's trusted reputation for high-quality patient care and broad regional network, Community Psychiatry receives consistent patient referrals from insurance carriers, local referring physicians and patient word of mouth.

The company operates at high psychiatrist utilization levels having built an extremely efficient patient referral conversion, scheduling and back office intake system. The Company was founded in 1995 and is based in Northern California.

Our Role

Duff & Phelps acted as the exclusive financial advisor to Community Psychiatry in connection with its sale.

Sell Side Advisor

THE MEADOWS®

has been acquired by

American Capital

Client

Founded in 1976, The Meadows is a multi-disorder treatment facility offering treatment for psychological conditions, compulsive and addictive behaviors, and affective disorders, such as post-traumatic stress, alcoholism, drug addiction, sexual compulsivity/aversion, major depression and bipolar disorders. Located on a 10 acre campus in Wickenburg, Arizona, The Meadows consists of an inpatient facility and an extended care facility. Treatment at The Meadows is personalized to meet individual needs. A multidisciplinary team of psychiatrists, psychologists and professional counselors work cooperatively and consistently with dedication to the best interest of each patient.

Our Role

Duff & Phelps acted as financial advisor to The Meadows in connection with its sale.

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