VECTOR MEDICAL GROUP

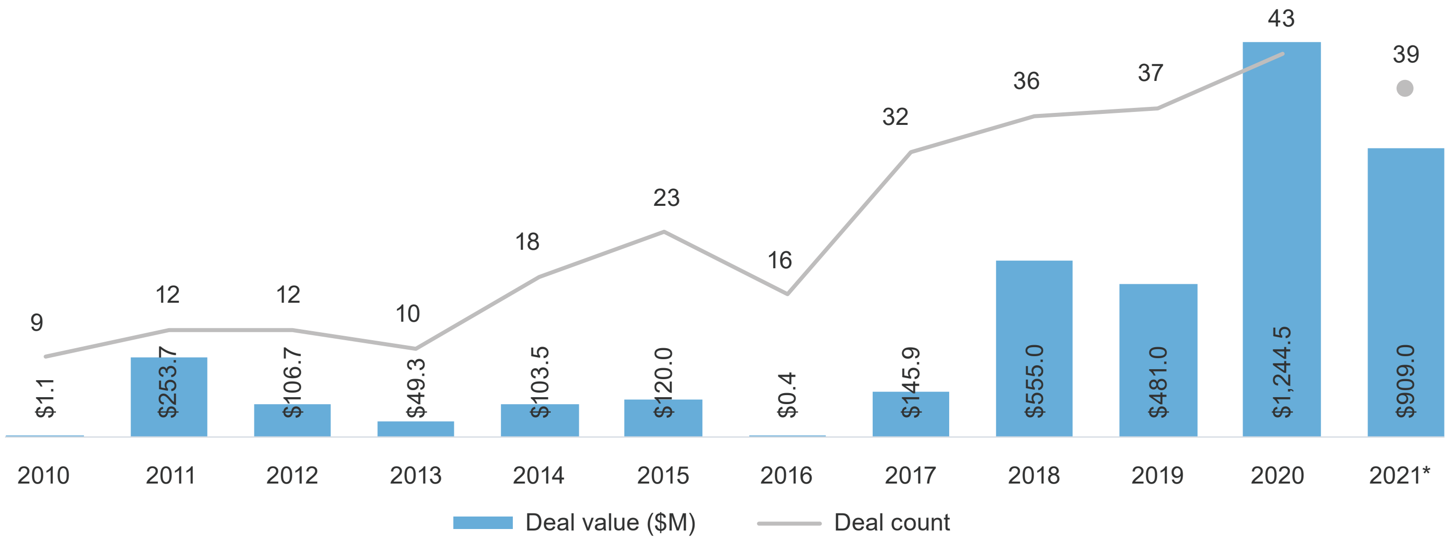
EPSTEIN BECKER GREEN

Private Equity's Push into the Mental Health Space

Data provided by PitchBook

COVID-19 prompts deal surge

Private equity deal activity in mental & behavioral health



Source: PitchBook | Geography: US | *As of October 13, 2021

Private equity is paying increasing attention to the mental and behavioral health space. The aftermath of the COVID-19 pandemic is the prime mover: PitchBook data shows an avalanche of deal volume in Q4 2020, with a record 22 deals in the space to close out the year. Historically, only a handful of mental and behavioral health deals have been completed each quarter, thus leading to modest annual numbers compared with other healthcare services. This momentum continued into 2021, with at least 11 transactions made in each of the past three quarters. That is substantial volume for an industry that had only five double-digit quarters before the pandemic.

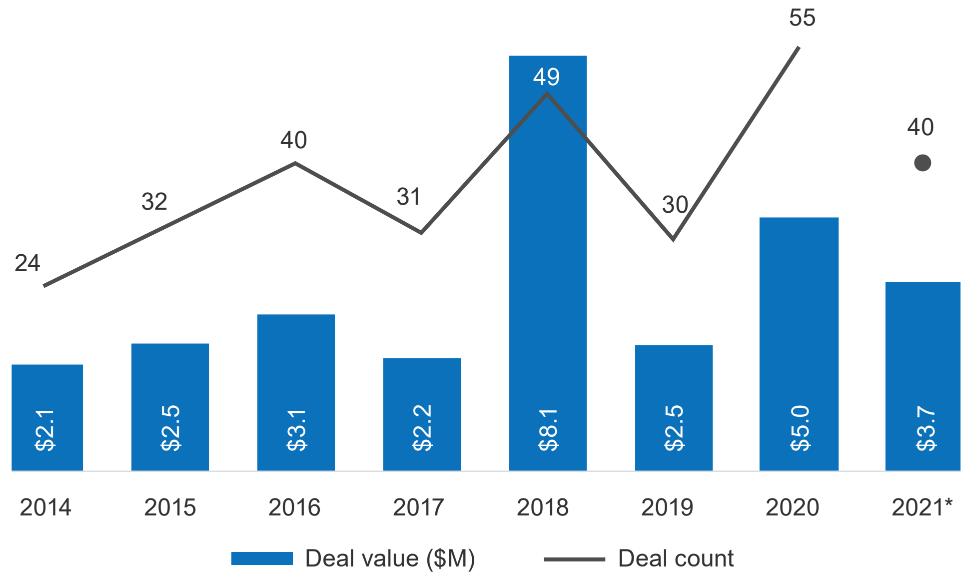
COVID-19 prompted a surge in patient demand and introduced new wrinkles in care access and delivery. Social distancing mandates and health concerns pushed that demand online. Prior to the pandemic, telemedicine technology was sparsely used; doctors and patients alike were skeptical of the practice. Under COVID-19, it became a must-have for care providers and an opportunity for private equity investors to provide the capital for implementation and upgrades.

Like other healthcare services, the mental and behavioral segment is highly fragmented and lacks scale. And, also like other healthcare services, those factors set the stage for private equity-guided consolidation—particularly for outpatient services. Add-on activity rose in earnest in 2020 as sponsors built out their platforms. Kelso Private Equity acquired Refresh Mental Health in October 2020. Since that deal closed, Refresh has already added on eight outpatient clinics. Kelso originally purchased the company from Lindsay Goldberg, which highlights another trend under COVID-19: prominent secondary buyouts as sell-side owners took advantage of heightened private equity demand. In another sign of demand, KKR created a new mental health services provider, Geode Health, in June 2021; it operates on a built-in hybrid model between in-person and virtual care.

The same dynamics are playing out in the drug & alcohol rehabilitation space. The pandemic spurred drug and alcohol consumption, sometimes at record levels. Demand for rehab services, which have traditionally been in-person and often inpatient, was stymied by social distancing mandates and strict rules about indoor gathering. Telemedicine is an emerging option for rehabilitators, as well.

Private equity activity surged in late 2020, with a record 19 transactions in Q4. Deal volume hit that mark again in Q2 2021. Between Q4 2020 and Q3 2021, PitchBook recorded 58 transactions altogether, with few signs of slowing going into 2022. Like the broader mental health segment, alcohol and drug rehab centers were on the receiving end of a wave of add-on proposals. BayMark Health Services, which was acquired by Webster Capital Management in 2015, has added on 13 times since the outbreak of COVID-19—accounting for more than half of its add-ons since being acquired six years ago.

Private equity deal activity in drug & alcohol rehabilitation services



Source: PitchBook | Geography: US | *As of October 13, 2021

Looking ahead

27.6%

Tragically, the knock-on effects of the COVID-19 pandemic continue to unspool, with The Lancet estimating that major depressive disorders worldwide rose by 27.6% since the pandemic's onset.[1] In the coming years, additional capacity in mental health services will be needed.

50%

Going forward, in an effort to prevent further negative health outcomes across demographics, demand for behavioral health funding and capacity will be high. For example, recent data reveals that waiting list registrations and deceased donor liver transplants both surpassed forecasts by more than 50%.[2] If the pandemic-driven increased alcohol consumption continues, these figures could remain elevated.

PE backers

Capitalizing on the hybrid models of virtual and in person that will likely remain popular, private equity backers have been investing more heavily in underlying tech infrastructure to support telehealth options. Increased PE activity in digital health capabilities related to core behavioral and rehab platforms is anticipated.

1. "Global Prevalence and Burden of Depressive and Anxiety Disorders in 204 Countries and Territories in 2020 Due to the COVID-19 Pandemic," The Lancet, October 8, 2021.
2. "Association of COVID-19 with New Waiting List Registrations and Liver Transplantation for Alcoholic Hepatitis in the United States," JAMA Network, Maia S. Anderson, M.D., Valeria S. M. Valbuena, M.D., Craig S. Brown, M.D., M.Sc., et al, October 26, 2021.

Key factors driving increased interest

The rapid growth in telemental and telebehavioral health during the COVID-19 pandemic, including changes in scope of practice regulations to increase telemental and telebehavioral health services access

Significant policy changes across all payer markets, including Medicare, Medicaid, and commercial insurance

Increased enforcement of the Mental Health Parity and Addiction Equity Act (MHPAEA), which resulted in further reductions in disparate use of management practices to control access to mental health services

Ongoing public attention and resulting governmental funding programs to address and mitigate the impacts of addiction, particularly with regard to the national opioid crisis

The rise in mental health issues due to isolation, depression, work-related burnout, and other ramifications of the pandemic, shutdowns, and virtual work

Increased employer awareness of the impact of mental health—and the COVID-19 pandemic in particular—on employee mental health and the resulting increased demand for employer-sponsored EAP and covered benefits for telemental health

Education of providers and increased access to information about behavioral health

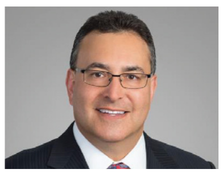
***Methodology**

All datasets are sourced from PitchBook, and all traditional healthcare industry codes correspond to existing industry codes for healthcare in the PitchBook Platform. Specific data for mental and behavioral health and drug & alcohol rehabilitation was derived using a combination of keywords and a primary industry code tag of "healthcare" to identify companies within the healthcare services space.

Q&A with Dana Jacoby, Gary Herschman, and Kevin Malone

Dana L. Jacoby
CEO
Vector Medical Group

Dana Jacoby is a national thought leader across numerous medical specialties including gastroenterology, dermatology, orthopedics, oncology, dermatology, and retina. The heart of her work is at the intersection of market data, measurement and analytics, strategy design and implementation, and technology innovation. Over the past decade, Dana guided her personal companies through multiple mergers and private equity transactions. In addition, she's consulted in nearly $1 billion in mergers & acquisitions, making her one of the most sought-after healthcare specialists in the country.



Gary W. Herschman
Board of Directors /
Member of the Firm
Epstein Becker Green

When healthcare companies undergo a major strategic transaction through mergers, acquisitions, consolidations, joint ventures, partnerships, buyouts, or new affiliations, Gary Herschman drives these important transactions to successful closings. His leadership of deal teams protects his clients' financial interests, in a regulatorily compliant manner. A skilled negotiator in major deals of any size—small ($5-$25 million), middle market ($30-$200 million), and large ($250 million to billion-dollar deals)—Gary balances the concerns of all parties, including physician groups, hospitals and health systems, ambulatory surgery centers, imaging centers, clinics and home health companies, lenders, investors, and state departments of health, to effectively structure and close complex deals.

Kevin J. Malone
Senior Counsel
Epstein Becker Green

Managed care organizations trust Kevin Malone to help them understand and navigate their most difficult legal, compliance, and strategic risks and opportunities. Kevin draws on more than one decade of experience working at the highest levels of healthcare financing policy and law to help managed care organizations navigate the web of federal and state regulations and program policies governing the healthcare financing system. Kevin is a go-to lawyer on issues concerning the Mental Health Parity and Addiction Equity Act (the federal parity law), delivery systems for Medicare-Medicaid dually eligible beneficiaries (such as special needs plans and the Programs of All-Inclusive Care for the Elderly (PACE)), and demonstration models for Medicare and Medicaid.

Prior to COVID-19, private equity appetite for the mental and behavioral space already existed. How did COVID-19 affect private equity sentiment, especially as the broader culture started to reassess its view on mental health?

The number of behavioral health sector investor deals increased from 37 in 2019 to 43 in 2020. Given that there have been 39 completed transactions in 2021 through Q3, the total deal count for the sector will likely exceed 50 this year. At the same time, transaction value increased considerably from $481 million in 2019 to a staggering $1.2 billion in 2020. Moreover, other organizations that compile data on healthcare transaction activity including smaller regional deals, such as Bloomberg, show activity increasing from 48 in 2019 to 80 in 2020 to 100 through Q3 2021—and likely to top 130 deals by year's end.

How does private equity view the mental health industry's business model, particularly around capital efficiency for outpatient clinics?

As compared with other medical specialties, behavioral and mental health practices are fragmented and disjointed across all platforms. At the same time, unprecedented demand has inundated the sector. Patients seeking behavioral and mental health services range from those with chronic mental health needs to those experiencing depression and/or anxiety for the first time. Unfortunately, most practice infrastructure was ill prepared for the increased service volume, and the capital requirement to meet the additional patient demand was prohibitive. According to national telebehavioral and telemental health providers, the increased demand for mental health professionals has begun to reach the limits of the current supply of licensed providers. The scarcity of providers will further drive up operating expenses and potentially slow the rate of growth until the industry trains additional practitioners. Private equity views acute care, such as psychiatric hospitals and partial hospitalization programs, as operationally inefficient. In contrast, outpatient programs targeting specific conditions with evidence-based clinical models, such as programs tailored to autism and addiction, require less capital. Consequently, these models of behavioral and mental health are highly sought-after investor targets. The data demonstrates a higher transaction value for practices that implement tools such as telebehavioral and telemental health models that, comparatively, require lower capital and treat a higher volume of patients.

Social distancing and telehealth emerged from COVID-19. Has the mental health industry—including potential investors in the industry—fully understood what telehealth's impact will be on the underlying business model?

COVID-19's key impact on the space changed the relationship between behavioral and mental health and the use of technology in telehealth. These trends will outlast the pandemic.

Telehealth has been an option to the medical industry for decades. However, until the pandemic, few doctors were experienced enough to or interested enough in remotely providing treatment options. The pandemic forced patients and providers to remotely interact by utilizing technology platforms. That combined with the unanticipated increase in demand for behavioral and mental health services has affected this sector in an unprecedented way. Whether the industry will permanently use telemedicine depends on several factors. Payers on both the governmental and private sides of the equation must agree to reimburse telebehavioral and telemental health practitioners as a permanent care model. The increase in MHPAEA enforcement and ongoing changes in the telehealth regulations will continue against the backdrop of the public health issues caused by the pandemic. Evidence-based models of primary and behavioral health integration, such as the collaborative care model, could emerge as a solution for the shortage of licensed, experienced providers by maximizing capacity without geographic limitations. The complicated environment of overlapping issues and contradictory changes ensures that no one can credibly predict the full impact of COVID-19 on the business model.

Where do you see investment in the space over the next two to three years? Do market players believe COVID-19's impact will be temporary or longer term?

Investment in the space will continue to grow, likely along a similar trendline as 2019 to 2021. Specifically, there will be growth in total transactions and be enhanced by greater growth in deal size. Demand for behavioral and mental health services will continue to grow for both employers and individuals. That phenomenon will pressure payers to increase remuneration for behavioral and mental health treatments. COVID-19's key impact on the space changed the relationship between behavioral and mental health and the use of technology in telehealth. These trends will outlast the pandemic. The factors influencing behavioral and mental health trends will continue to drive small and individual practitioners to consolidate through transactions of all sizes.