Investment & Consolidation in Addiction Treatment

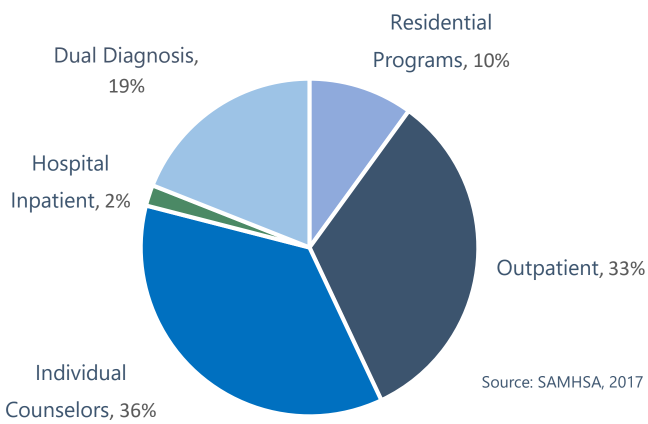
The Substance Abuse sector has experienced significant investment activity as rising demand and significant fragmentation within the sector continue to create a ripe environment for consolidation.

INTRODUCTION

Substance abuse and co-occurring disorders such as depression and anxiety are at the forefront of a national health crises facing the United States. As a result, addiction treatment has rapidly become one of the most highly sought-after subsectors of healthcare services for investment as a multitude of key tailwinds at both the macroeconomic and microeconomic level have promoted the flow of private equity dollars into the sector.

According to a 2017 Substance Abuse and Mental Health Services Administration (SAMHSA) survey, there were 4,220 inpatient, 11,836 outpatient, and 6,749 dual diagnosis addiction treatment programs across the nation. Despite the preponderance of facilities, a 2017 National Survey on Drug Use and Health reported an estimated 20.7 million individuals aged 12 and older battled a Substance Use Disorder (SUD), with roughly 19% receiving the treatment they required.

National Provider Concentration



Per the National Institute on Drug Abuse (NIDA), the relapse rate for Substance Use Disorders is estimated to be 40%-60% — the same frequency of other chronic diseases such as hypertension and asthma — further compounding the need for cost effective and high-quality platform providers.

Between 2007 and 2015, overdoses from both licit and illicit drugs spiked 230% and the economic impact of substance abuse consequently ballooned to a staggering $445 billion.

According to substance abuse service providers, the real cost of the drug epidemic hemorrhages the US economy by a staggering $1 trillion annually. Data shows that approximately $4 and $7 are saved in healthcare and law enforcement costs, respectively, for every $1 spent on substance abuse treatment, with the primary cost drivers including emergency healthcare services and loss in production from afflicted workers.

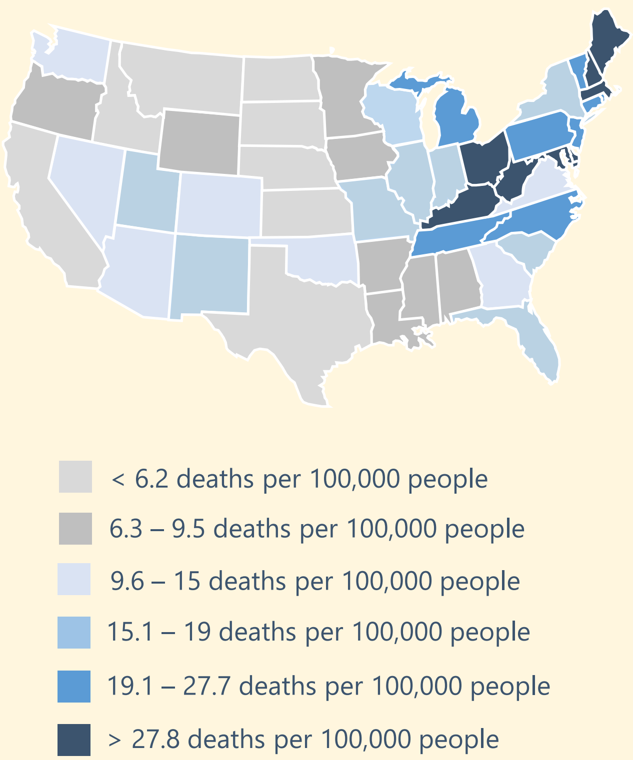
In light of the need for services, private equity firms have begun investing into substance abuse players across a number of service lines in order to scale platforms to meet the growing demand for services.

ADDICTION TREATMENT SERVICES INDUSTRY

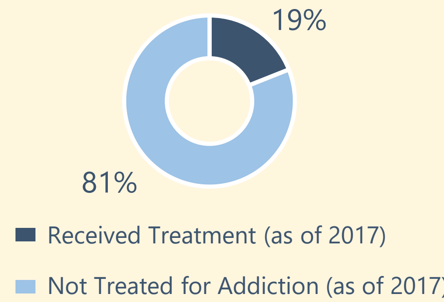
Market Tailwinds

The passage of the 2008 Parity Act facilitated a more accessible treatment continuum for patients with substance abuse disorders and helped elevate addiction benefits to the same level as medical/surgical benefits. However, the industry continues to exhibit an unmet need for addiction treatment services as demand continues to rise, representing a growth opportunity for investors.

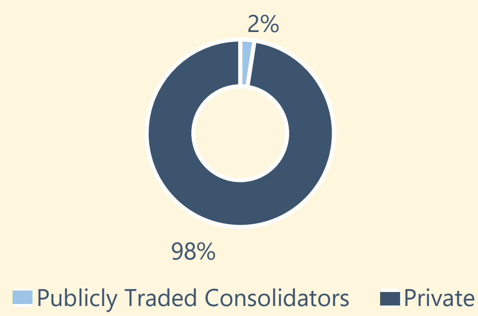
Opioid-Related Overdose Death Rates



Patient Population Receiving Treatment



Market Fragmentation



Sources: 2017 National Survey on Drug Use and Health, National Institute on Drug Abuse (2017), SEC 10-k Fillings ACHC and UHS

Addiction treatment services can be administered in a wide variety of settings (detox, inpatient, partial hospitalization, outpatient), but are primarily provided through specialized treatment facilities that focus on various levels of care, often vertically integrated. Treatment plans may also include components such as counseling and therapy, medication management, education, relapse prevention, support groups, transitional services, co-occurring disorder treatment, and alumni/aftercare programs, among others. Different forms of treatment environments range from flexible outpatient programs that work around the patient's schedule, to more structured inpatient or residential programs where the patient stays onsite for a set amount of time.

According to a SAMHSA 2017 study, 47.4% of individuals seeking treatment were substance abuse primary, 15.6% alcohol primary, and 37.0% sought treatment for both.

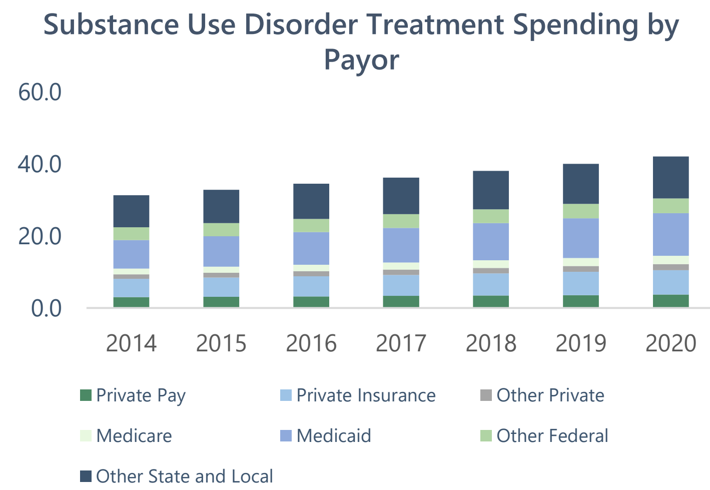
Substance use disorder treatment has historically been driven by private pay patient services. With the passage of the Parity Act in 2008 and increased adoption from commercial payors as a function of lowering SUD related healthcare costs, private and government insurers are becoming an increasingly large segment of the payor mix.

ADDICTION TREATMENT SERVICES INDUSTRY

According to the Center on Budget and Policy Priorities, nearly 12% of all adults enrolled in Medicaid have a SUD. While Medicaid remains a core payor for larger players such as Acadia Healthcare and UHS, Medicaid reimbursement rates are often prohibitive towards smaller providers that lack the level of scale to profitably provide care for government reimbursed patients. However, for private equity-backed organizations that have the financial resources to expand the breadth of their operations, Medicaid can become an attractive expansion opportunity to drive patient volume.

Furthermore, addiction centers have begun to diversify their services into mental health and eating disorder offerings. This has led to increased revenue streams, longer care stays, and has addressed issues of co-morbidity frequent with alcohol and substance abuse clientele.

Given the varied treatment settings for addiction treatment services, private equity firms are attracted to the multitude of options available for growing a portfolio investment within the sector across a number of service, payor, and geographical segments.



Source: Center on Budget and Policy Priorities

"With the passage of the parity act in 2008 and increased adoption from commercial payors as a function of lowering SUD related healthcare costs, private and government insurers are becoming an increasingly large segment of the payor mix."

A HIGHLY FRAGMENTED MARKET

The addiction treatment sector is highly fragmented, with the two leading publicly traded players only representing ~2% of total market share, as a percentage of the total number of centers in the United States.

2018 was a landmark year for private equity activity within the sector, led by new platform investments and add-on acquisitions from large private equity-backed programs across numerous program types (out-of-network inpatient and outpatient, MAT-focused, etc.). Delphi Behavioral Health Group partnered with The Halifax Group in 2017 and has since made two key acquisitions, Serenity at Summit (2018) and Family Recovery Specialists (2018), expanding its geographical footprint within the northeastern and southeastern United States. Treatment modalities, however, continue to be innovated across the substance abuse sector, evidenced by the expansion and increasing clinical adoption of Medication Assisted Treatment (MAT) in recent years.

In 2018, the Food and Drug Administration (FDA) publicly issued recommendations supporting the efficacy of MAT services in helping combat the national opioid crisis. MAT offers an integrated treatment plan by leveraging doses of specific FDA-approved drugs (i.e. methadone and buprenorphine) alongside counseling and psychosocial support. By February 2019, the FDA had announced the government's perpetual commitment to promoting the widespread facilitation, adoption, and delivery of MAT.

BayMark Health Services, a portfolio company of Webster Equity Partners, acquired six behavioral healthcare service providers, bringing its total deal count since partnering with Webster Equity in 2015 to 13. Given the success in scaling BayMark through acquisitions to become the largest provider of MAT services in North America, Webster is currently in the process of exiting its investment in the Company to another private equity firm.

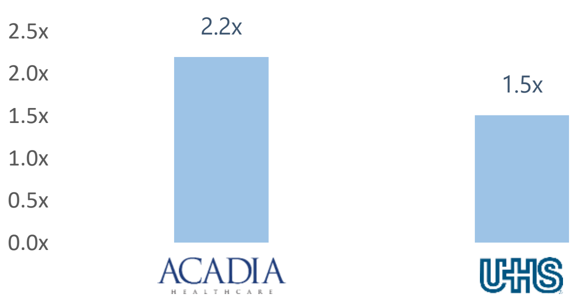
Clearview Capital, another experienced healthcare services investor, contributed to the consolidation wave through its MAT-focused platform, Community Medical Solutions, closing and integrating two MAT providers in 2018.

Other PE backed providers, such as Pinnacle Treatment Centers backed by Linden Capital, have diversified their mix by providing both abstinence-based programs as well as diversifying into outpatient MAT programs.

Leading Publicly-Traded Providers

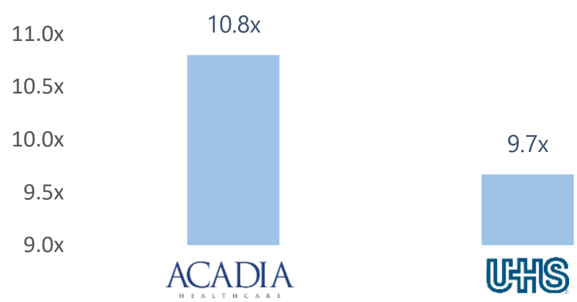
EV/Revenue

TTM July 2019



EV/EBITDA

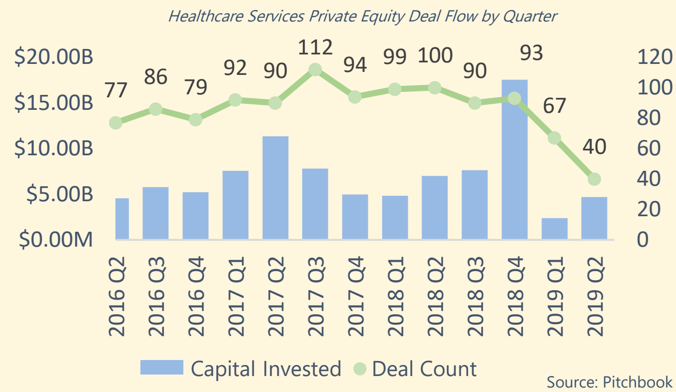
TTM July 2019



Source: Pitchbook

PRIVATE EQUITY EXPLAINED

What is Private Equity?



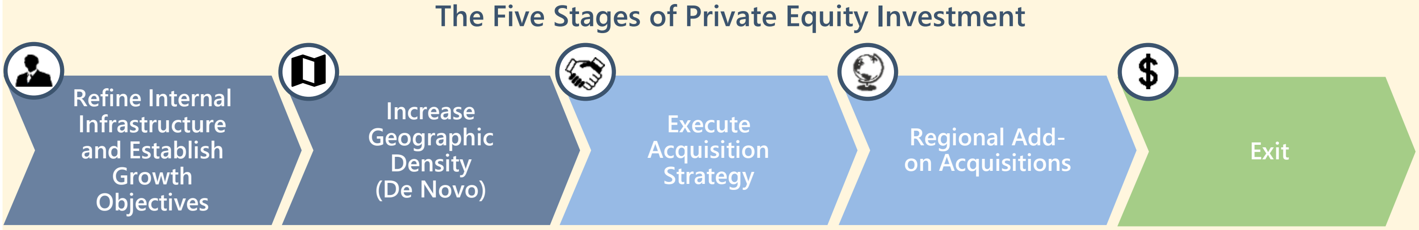
Private equity refers to investors and capital funds that seek to make direct, equity investments in privately-owned companies. General Partners (GP's) manage and deploy the capital allocated to their fund to invest in businesses that align with the management team's core investment theses. GP's typically exit their investment anywhere between 3-7 years after orchestrating and executing momentous growth initiatives to ensure substantial returns for their fund investors. Limited Partners (LP's) are passive capital investors, including pension funds, endowment plans, and institutional investors, that seek to attain prodigious returns on their capital commitments in a private equity fund.

After an attractive investment opportunity is identified, private equity firms will acquire a stake in the business by providing a bundle of both significant liquidity in the form of cash proceeds and equity ownership in the newly recapitalized business. Post-transaction, private equity firms strategically utilize their seasoned, operating and financial expertise to help their investments build out infrastructure (medical technology, back-office optimization, etc.) and set up leverageable roots to capitalize upon for future growth.

GP's typically employ a board-level advisory strategy to help counsel and grow their portfolio companies, leaving the daily operations of the business in the hands of the current management team. Private equity growth strategies can vary depending on the business model in question but usually gravitate around injecting capital into portfolio companies – to organically grow the business through de novo locations and inorganically execute on acquisition targets to help drive expansion efforts into new geographies, foster increased patient mindshare, maintain leading positions in target markets, and amplify holistic brand equity.

The end game for a private equity firm is selling their ownership stakes, at significant profit margins, to another private equity firm or strategic acquirer and providing current capital contributors with the means to participate in additional liquidity opportunities. Through the invaluable intellectual and financial capital offered by private equity funds, businesses can scale at unprecedented growth rates and earn unparalleled returns at each liquidity inflection point over its life cycle.

The Five Stages of Private Equity Investment



PRIVATE EQUITY IN ADDICTION TREATMENT

The addiction treatment sector's diverse buyer landscape includes strategic acquirers that allow owners to join a publicly traded or private equity-backed company, and financial partners that allow owners to become the first investment into the sector for a private equity firm. Due to differing seller preferences, business structure, and regional competition, both buyer types can add unique value.

Private Equity Firms With No Current Investment in Addiction Treatment

Private Equity-Backed Platform Consolidators

General Behavioral Health Industry Consolidators

The first private equity investment in addiction treatment closed in 2002 when CHL Medical Partners acquired MedMark Treatment Centers, followed by Waud Capital Partners' investment in Acadia Healthcare in December 2005.

Since these early transactions, which created some of the largest national consolidators in the sector today, the substance abuse market has witnessed robust growth in deal flow from both PE and strategic acquirers. In 2018, there were 45 transactions announced.

The investment thesis across private equity is relatively consistent; invest in a platform caliber business and scale the organization through organic and acquisition growth over a holding period of three to seven years. During that period, the PE firm will work closely with current management to implement or upgrade current EMR and back office operations to allow for planned aggressive growth initiatives.

PE firms will then exit, typically to another private equity firm or strategic acquirer, with the expectation of a 3-5x return on their invested capital.

The growth in interest for addressing SUDs is evident through the entry of large multi-billion dollar PE funds in the behavioral health sector such as Odyssey Behavioral Health being acquired by The Carlyle Group (2018), one of the world's largest PE firms. Provident expects strong private equity investment volume in addiction treatment to continue through the creation of new platforms as well as the exchange of current private equity platforms to new entrants and larger PE funds.

PRIVATE EQUITY IN ADDICTION TREATMENT

Private equity firms will generally seek a controlling interest in their portfolio companies through equity ownership between 60%-80%, with existing shareholders retaining a 20%-40% stake in the business.

The Enterprise Valuation, or purchase price, of an addiction treatment program is typically based on a multiple of the "Adjusted EBITDA" or "Adjusted Earnings Before Interest, Tax, Depreciation, and Amortization" of the business. The purpose of this calculation is to understand the go-forward or normalized level of earnings in the organization, adding back any one-time, non-recurring, or personal expenses. Adjusted EBITDA, or the normalized cash flow of the organization, will be a key source of growth funding for the business going forward, as this cash will typically not be distributed to partners at year end.

Important considerations in determining valuation multiples include scale, administrative and operational infrastructure, competitive positioning, and geographical presence, amongst others. Today, Adjusted EBITDA valuation multiples in a competitive transaction process in addiction treatment are among the highest in the healthcare service industry.

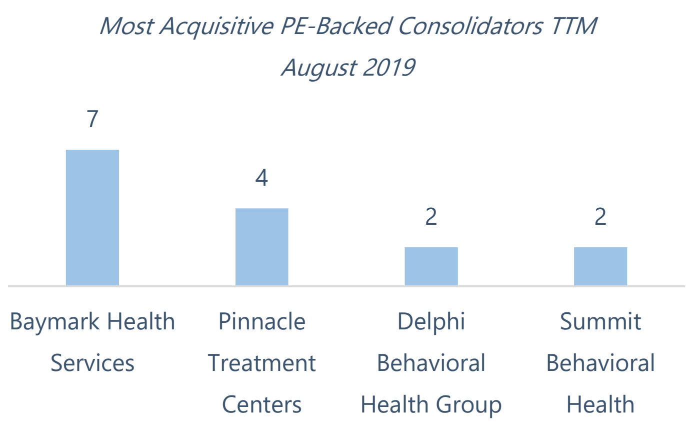
As the substance abuse continuum shifts towards in-network providers, expanded behavioral health services, and consolidated platform operations, PE-backed platforms will look to leverage scale for efficiency of operations and better relationships with payors, providing better quality of care and reduced costs to patients.

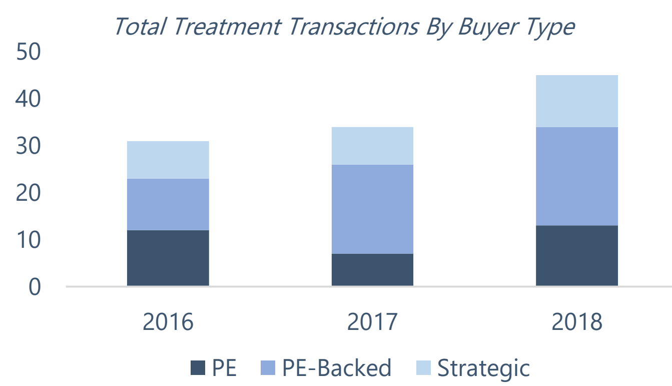
What Makes A "Platform"

Platform investment opportunities are attractive to private equity investors due to the innate characteristics these businesses exhibit to execute upon growth strategies. Below are common factors that drive premium valuations in private equity transactions.

- ✓ Strong, experienced management team prepared to lead aggressive organic and acquisition growth strategies.
- ✓ Substantial investment in back-office infrastructure to help support increased patient volumes, complexity in the payor environment, and diversified service offerings.
- ✓ Multi-location footprint that captures patient volume from a wide array of geographic locations as well as a multifaceted payor mix.
- ✓ Strong brand equity as a high-quality, ethical provider within communities they serve.
- ✓ Sophisticated SEO management and marketing initiatives.

PRIVATE EQUITY IN ADDICTION TREATMENT





Recent Substance Abuse Transactions

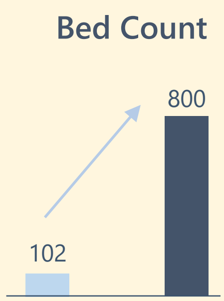
Year	Target	Buyer	Target Location
Jul '19	BayMark Health Services	KSPS Medical Consultants & OBOT	Bowling Green, KY
Jun '19	Anthem	Beacon Health Options	Multiple Locations
Jun '19	Kolmac Outpatient Recovery Centers	BioCare Recovery	Yardley, Pennsylvania
Jun '19	Rising Biosciences	Southern Northern Behavioral Health	Sandusky, OH
Jun '19	Newport Academy	Gray Wolf Ranch	Port Townsend, WA
Jun '19	BayMark Health Services	AMC Nashville	Nashville, TN
Jun '19	Next Chapter Treatment Center	All Points North Lodge	Edwards, CO
May '19	Arsenal Capital Partners	HopeBridge	Multiple Locations
May '19	Pinnacle Treatment Centers	Addiction Medicine Center	Columbus, OH
Apr '19	BayMark Health Services	Recovery Services of New Mexico	Albuquerque, NM
Apr '19	Bridges Fund Management	Sunrise	Cincinnati, OH
Apr '19	Sprout Health Group	Endeavor House North	Kearny, NJ
Apr '19	Pinnacle Treatment Centers	AATC & AMS	Williamsburg, VA
Mar '19	BlueMountain Capital Management	Promises Behavioral Health	Long Beach, CA
Feb '19	Ashley Addiction Treatment	Aquila Recovery	Washington, D.C.
Feb '19	Acadia Healthcare	Mission Treatment Centers	Escondido, CA
Feb '19	BlueCross BlueShield	Ideal Option	Kennewick, WA
Feb '19	Rosecrance	Jackson Recovery Centers	Sioux City, IA
Jan '19	Hackensak Meridian Health	Carrier Clinic	Belle Mead, NJ
Dec '18	Vistria Group	Behavioral Health Group	Dallas Fort-Worth, TX
Dec '18	The Carlyle Group	Odyssey Behavioral Healthcare	Brentwood, TN
Nov '18	Discovery Behavioral Health	Ambrosia Treatment Center	Medford, NJ
Nov '18	Community Medical Services	Premier Care & MARs	Multiple Locations
Nov '18	BayMark Health Services	Metamorphosis	Salt Lake City, UT
Oct '18	Atar Capital	Pathways & Community Support	Multiple Locations
Oct '18	Seaside Healthcare	Faith in Families	Reidville, N.C.
Oct '18	Pyramid Healthcare	WaldenSierra	Charlotte Hall, MD
Oct '18	BayMark Health Services	Tri-City Institute	Los Angeles, CA
Oct '18	Fulcrum Equity Partners	Life of Purpose Treatment	Bacon Raton, FL
Sep '18	Summit Behavioral Healthcare	St. Gregory Retreat Center	Bayard, IA

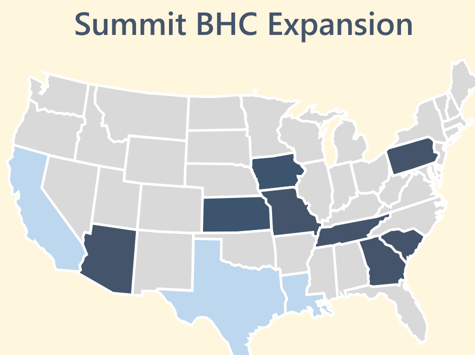
PRIVATE EQUITY IN ADDICTION TREATMENT

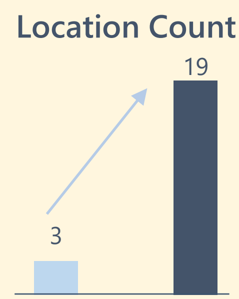
The following case study illustrates how a private equity partner can help fuel the growth of an addiction treatment platform.

Summit Behavioral Healthcare Case Study

Flexpoint Ford, a private equity firm, acquired a controlling stake in Summit Behavioral Healthcare ("Summit BHC" or the "Company") in March 2015. Summit BHC is a leading provider of treatment facilities that are solely focused on helping adults and families suffering from alcohol and drug addiction. The Company offers a wide array of patient programs including detoxification, partial hospitalization, intensive outpatient, health & wellness, residential chemical dependency, and dual diagnosis treatment. At the time of the original transaction, Summit BHC operated three clinics, in Houston (Texas), Sacramento (California), and Lafayette (Louisiana), with a cumulative total of 102 beds.







Pre-transaction as of March 2015 | Post-transaction as of July 2019

Flexpoint Ford acquires Summit BHC	→	Summit BHC opens 3 de novo locations and makes 7 add-on acquisitions	→	Flexpoint Ford sells Summit BHC to Lee Equity Partners and FFL Partners
March 2015		**2 Year Hold Period**		**October 2017**

Under Flexpoint Ford's leadership, Summit BHC established a national presence by growing their footprint from 3 to 9 states and aggregate bed count from 102 to 662, through de novo and external growth initiatives. The Summit BHC platform opened three new locations and executed eight strategic acquisitions across six new states under Flexpoint Ford's ownership, ultimately diversifying the Company's geographic footprint and driving enormous brand equity. In October 2017, Flexpoint Ford exited to two other Private Equity Firms (Lee Equity Partners and FFL Partners).

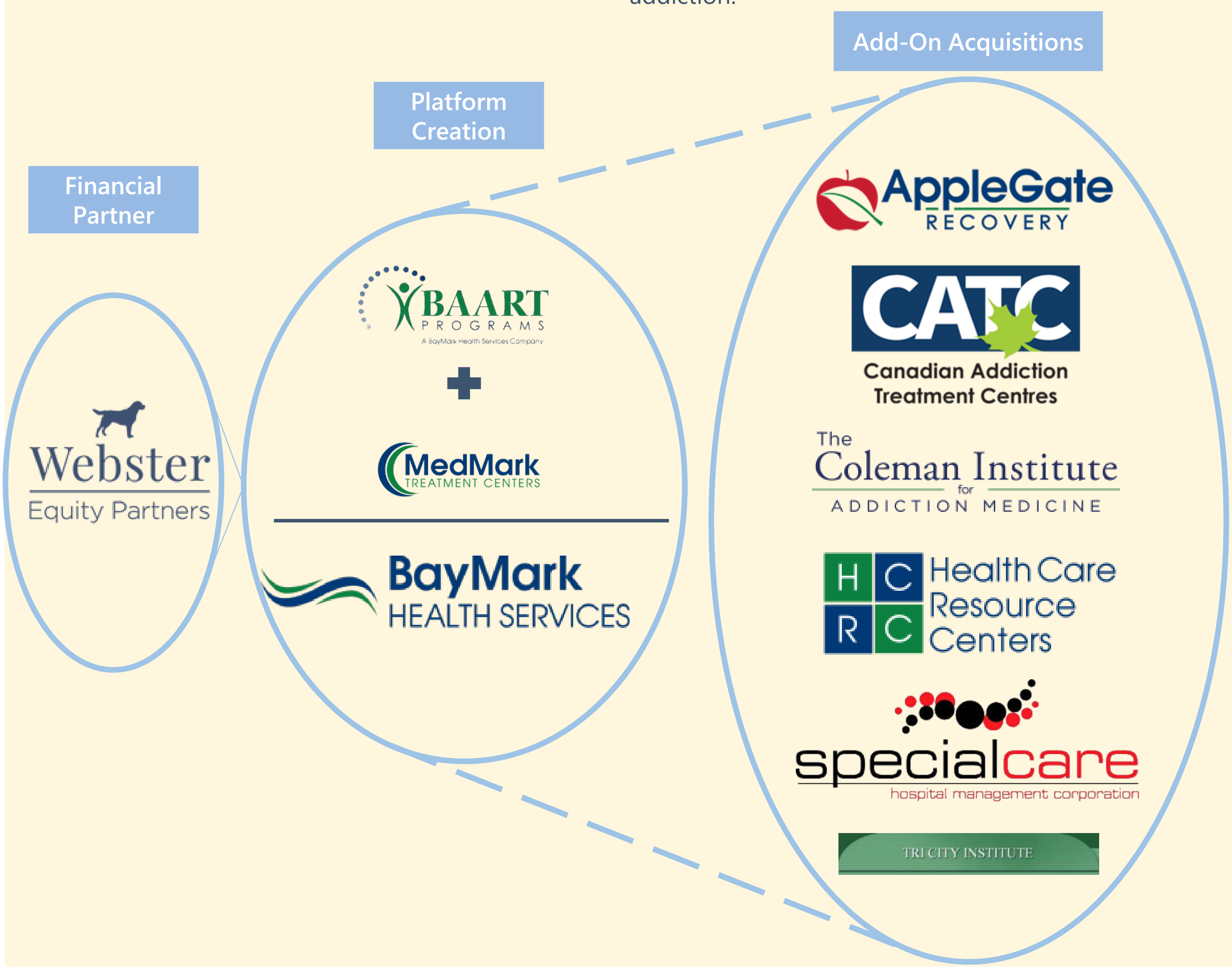
With the help of Lee Equity Partners and FFL Partners, Summit Behavioral Health expanded their operations further. Summit BHC made another add-on acquisition in February 2018, netting entry into a new target market and 65 additional beds,. In the four years since their initial partnership, private equity leadership helped Summit BHC acquire significantly larger market share than if they had attempted to scale independently.

PRIVATE EQUITY ACTIVITY

BayMark Health Services Case Study

Webster Equity Partners created BayMark Health Services in 2015 by merging Bay Area Addiction Research & Treatment (BAART) with MedMark Services, two portfolio companies they had acquired during the year. BAART was the sixth largest national provider of opioid treatment services and MedMark offered outpatient addiction treatment services to patients through 22 locations spanning five states.

Under the continued leadership of Webster Equity Partners, BayMark Health Services has leveraged an aggressive acquisitive growth strategy to quickly establish itself as the leading opioid treatment provider in North America. BayMark now boasts a geographical footprint across 25 states and 1 province in North America, while offering substance abuse patient populations over 167 programs to help combat addiction.



CONCLUDING THOUGHTS

The overarching macroeconomic tailwinds driving the need for quality care within the addiction treatment sector has expanded the growth and exit options available for treatment programs nationally.

As providers address a growing population in need of treatment, private equity firms offer a partnership opportunity to help companies aggressively scale their footprint through acquisitions and organic initiatives, while maintaining the strong clinical framework that allowed the program to flourish in the first place.

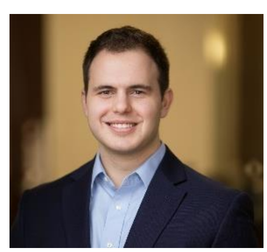
With continued investment and consolidation within the addiction treatment sector creating larger and more networked organizations, the market will become more competitive both on the recruitment of clinical and administrative professionals, but also in capturing patient volume throughout the continuum of care.

For treatment programs that have invested in their operational infrastructure and have created an environment of clinical excellence, the opportunity presents itself to become a private equity platform or regional acquisition to a private equity-backed platform in order to further expand the program and reach more patients in need.

There is considerable competition in a transaction process for regionally dominant assets today, resulting from the number of private equity firms that are actively seeking platform investments in the space and the dozens of private equity-backed platforms in the sector.

Provident expects valuations to remain elevated and investment momentum to continue as escalating demand and industry fragmentation drive consolidation in addiction treatment.

Provident Addiction Treatment Sector Contact:



Joseph Wisniewski
Associate
Direct: (310) 919-4014
Email: jwisniewski@providenthp.com

Provident is the leading investment banking firm specializing in merger and acquisition advisory, strategic planning, and capital formation for middle-market and emerging growth healthcare companies.

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Boston:
260 Franklin Street, 16th Floor
Boston, Massachusetts 02110
617-742-9800

Los Angeles:
315 S. Beverly Drive, Suite 504
Beverly Hills, California 90212
310-359-6600