

HEALTHCARE HAPPENINGS

F A L L 2 0 1 6



- ▶ **FIVE REVOLUTIONARY FORCES SHAPING HEALTHCARE INVESTMENT**
- ▶ **VALUE-BASED PAYMENTS CALL FOR DRAMATIC CHANGE TO HEALTHCARE OPERATIONS**
- ▶ **WHO ARE THE RISING STARS IN PRIVATE EQUITY HEALTHCARE ROLLUPS?**
- ▶ **PERSPECTIVE IN HEALTHCARE: A FEATURE EXAMINING THE ROLL OF PRIVATE EQUITY IN THE HEALTHCARE INDUSTRY**

FIVE REVOLUTIONARY FORCES SHAPING HEALTHCARE INVESTMENT

Waves of change are cresting across the healthcare landscape like the Industrial Revolution swept across continents more than 200 years ago. Propelling the change is a massive transformation in the system of reimbursement used by the Center for Medicare and Medicaid Services (CMS). The old world of fee for service is disappearing, replaced by a new era of value-based purchasing where payment is explicitly linked to clinical outcomes. At stake is nothing less than the entire \$3 trillion U.S. healthcare system, affecting providers, lenders, patients, payers, consumers and investors alike.

Driving the process are five revolutionary forces that we believe will continue to reshape healthcare investing regardless of near-term political pressures.

Force #1: Genetic code and computer code are converging

Molecular biology and computer science allow the development of new therapies to repair DNA “software defects” that cause many cancers. These innovations will create the ability to reprogram immune systems to fight off a broader variety of diseases and enable the harnessing of stem cells to repair and regrow body parts.

The convergence of genetic and computer code enables the automation of medical records and medical devices alike, and therein lies the rub. A software-controlled insulin pump embedded in your body could improve your quality of life considerably but also expose you to hackers.

Healthcare information technology (IT) will prove far more vulnerable to cybersecurity threats and intrusions than banks and the military, and healthcare providers are less prepared to deal with the problems. The vulnerability can be even more dire when a hospital's IT system crashes and it becomes practically impossible for doctors and nurses to take care of patients.

Privacy concerns will escalate. Integrated health systems and networks will be severely challenged to unify their data systems. Every one of these digital relationships presents a new set of cyber vulnerabilities and challenges. Case in point: A recent cybersecurity event in a medical center resulted in the shutdown of the center's computers and connected medical devices for more than a week.

Force #2: Mobile technologies are coming into their own

Twenty years ago the convergence of electronic communication and healthcare meant that radiologists in India used long distance landlines to read X-rays in Indiana.

Today's mobile technologies are much more sophisticated, allowing your health to be monitored in ways that once required you to be put into intensive care. In the not-too-distant future, an Apple Watch on your wrist at home will be able to transmit your blood sugar readings across town or across the globe.

The National Institute of Health has developed a wearable chemical sensor system to assess your exposure in real time to potentially health-threatening levels of hydrocarbon and acid vapors during emergencies. The sensor's readings can be transmitted through a cellphone connection to a receiving laboratory for immediate analysis. The system is also useful in wide-scale environmental disasters. During the Gulf oil spill, researchers used the sensor to successfully track and measure levels of leaking oil at varying depths over significant distances.

Continued on the following page...

BMSS HEALTHCARE PRACTICE GROUP

In today's world, outside influences ranging from politics and public demands to investors and cybersecurity threats create an environment in which healthcare administrators have to worry about more than just healthcare. So, how do you keep these growing demands at bay so you can continue to do what you love best? You hire great advisors to help you navigate the waters and stay on course.

With the ever-changing landscape of policies, regulations and restrictions, it is more and more important to ensure that you have the right accounting team in your corner. At Barfield, Murphy, Shank & Smith, we are committed to bringing you peace of mind for your accounting and tax matters so that you are able to focus on your operations, people and patients. We can provide you with the tools needed to make sure that you have the right internal controls in place, your tax returns or financial statements are completed timely and efficiently and you have access to a team of professionals who are available to consult with you on the multitude of issues that you face every day.

Additionally, as market pressures increase, healthcare organizations across the continuum will need to consider more than just normal operations, they will need to contemplate mergers and acquisitions, redesign of operations or infrastructure as well as implementation of new systems in order to stay ahead of the game. This translates to the need for more capital. Let our professionals help guide you through these turbulent waters so you can chart a course for success.

Thought Leaders:



Derrel Curry, CPA, CGMA
Member
Dcurry@bmss.com
205.982.5575



Kimberly Tarnakow, CPA
Senior Manager
Ktarnakow@bmss.com
205.982.5529

Five Revolutionary Forces...Continued

Capabilities like these can allow health professionals to diagnose disease, monitor wellness and improve health 24 hours a day, seven days a week. Mobile technologies also can help control the global threat from new and old diseases, since cellphones are rapidly expanding in many parts of the world that have little access to other forms of electronic communication.

Force #3: Return on capital is going negative

Most healthcare businesses over the past 30 years have been safe, money-making investments, but value-based payments introduce significant new risks and raise the specter of negative returns on capital. We believe that \$10 trillion of wealth will be created if you're invested in the right areas, but \$4 trillion will be lost by investing in the wrong areas.

In this new environment, certain investments no longer make economic sense. Skilled nursing facilities, for example, are being challenged. Hospitals are going to be in trouble. BDO USA, LLP estimates that half the hospitals in the United States are currently losing money. Banks that lend money to these facilities will be in trouble. With so many opportunities to lose money, investors will need to understand both clinical and financial data, not just one or the other.

All these changes are occurring in a financial environment that is fairly opaque. As a result, investments are being made with less than a 360-degree view, resulting in assets that are significantly mispriced. Investors have been buying without understanding the complex interplay of clinical practice, finance, data analytics and the legal and regulatory environment. To make matters worse, historically inexpensive debt has helped create a toxic environment that we believe will lead to significant restructuring activity across the healthcare industry.

Force #4: Integrated supply chains are becoming the norm

The development of integrated supply chains will provide care on an industrial

scale, replacing the mom-and-pop and single-shingle approach to healthcare delivery. Individual healthcare silos will disappear. If you need your hip replaced, the surgeon will not be separate from the hospital or the drugs or the rehabilitation facility or the home healthcare agency. Just the opposite, in fact.

CMS' mandatory Comprehensive Care Joint Replacement Program (CJR) changes the rules, assigning risk to the primary convener of services, which in most cases will be the hospital. This requires hospitals to organize and manage care far beyond the "four walls" of their facilities, making them responsible for the cost and quality of care provided by skilled nursing facilities. As the convener of care, the hospital is required to find all the providers, charge one unified price, be paid by CMS at that single price and then find an equitable way of distributing the fee to all the players. equitable way of distributing the fee to all the players.

If this sounds like how most other parts of the economy work, it is. Boeing builds its 787 Dreamliner with the help of 10,000 suppliers coming together in one gigantic integrated supply chain. One company makes the engine, another makes the seats, yet another makes the altimeter and so on.

In healthcare right now, there's no one like a Boeing doing this. But we believe over time that hospitals may slowly start looking like the Boeings of the world. They're in the first position to do so, though they may not have the necessary capabilities. Physician groups may try with private equity backing. Skilled nursing facilities may test the waters.

Those who figure out how to successfully integrate all the necessary healthcare components will be part of the \$10 trillion in new wealth we expect this brave new healthcare world will create.

Force #5: Patient care is moving away from hospitals

The advancement of treatment modalities through science and new

care protocols will move much of the care currently provided in hospitals to non-hospital settings. The signs are everywhere. Outpatient surgery is skyrocketing. Urgent care facilities and freestanding emergency rooms are becoming commonplace in urban areas. Procedures as different as childbirth and hip replacements have been reduced to a single day's stay.

All these changes beg serious questions. What will be the role of the modern hospital? How many hospitals do we really need? Who will pay for them? They may well be the convener of care, but patients will not spend significant time there. For a hip replacement you only spend 1.5 days in a hospital for a 93-day episode. You spend most of your time in a skilled nursing facility before going home and being treated by home healthcare. Who is responsible for your care? Who makes sure the care is coordinated?

How will future medical doctors be trained? When hospital stays lasted for weeks, medical students could see patients' progress. If you were a house officer, you lived and slept in the hospital so you could see the trajectory of your patients. How will you do that now?

How will hospitals manage their debt? They are sitting on approximately \$300 billion in real estate. They need to generate a great deal of cash to pay their debt. If more and more procedures leave the four walls, there is less and less revenue. What does their future look like?

Challenging times ahead

Radical changes in the way healthcare and treatment are measured and reimbursed are disrupting operating models across the healthcare continuum. Symptoms of strain on the system are all around. Recent news stories of alleged price gouging and the current political discussion on drug pricing present clear examples of a system struggling to transform itself within the context of difficult and shifting regulatory and competitive environments. New

Continued on the following page...

Five Revolutionary Forces...Continued

regulations are changing rules for operating and compliance. Nontraditional competitors are entering the fray, specifically for providers and payers.

Despite the turmoil, there is good news. The impact of all these changes will create several trillion dollars in value over the next 10 years for companies, innovators and organizations that successfully navigate the turbulence. Real innovation is certainly underway. Many organizations are redesigning and

disrupting existing operating models, raising capital through divestitures or sales of non-strategic operations and assets, and investing in change management to reposition themselves for the new models of care and payment.

Programs like the CJR—where innovation, reimbursement, patient care and regulation converge—offer a model to follow. The CJR could serve as an important indicator that more episodes of care will align payment with quality of care. The bundling of care is also

likely to lead to an unbundling of certain assets through efficient redesign, capital recalibration or restructuring.

The upshot? Reduced reimbursement and clinical outcome corroboration may ultimately function as fundamental drivers for change, restructuring and redesign. Meanwhile, the interplay of regulation, reinvention, redesign, restructuring and reimbursement will determine winners and losers.

VALUE-BASED PAYMENTS CALL FOR DRAMATIC CHANGE TO HEALTHCARE OPERATIONS

“For sale” signs heavily populate the healthcare landscape, enticing investors to shop around for a good deal. The appeal is strong: a highly fragmented market in the midst of major change and an aging population that will drive up demand for services. But the changing reimbursement environment is creating cracks that run deep into the core of the business model.

Great investment opportunities exist, but extreme diligence is a necessity. Investors need to take a 360-degree view of potential acquisitions—not just digging into the finances, but also examining the operational, clinical and regulatory risks. What adjustments must be made to business operations to accommodate the changing reimbursement environment? What needs to be done to improve clinical performance, both from a financial standpoint and with regard to outcomes (which are now more heavily factored into reimbursements)? If clinical and/or operational changes are made, how will the balance sheet need to be restructured? How much time do the changes require, and what has to be tackled immediately?

A thorough and thoughtful approach is needed to identify the major issues and redesign a structure that will thrive in the new environment. Traditional restructurings that focus on recapitalizing balance sheets with new debt won't

suffice. Fresh capital won't fix the underlying problems facing healthcare organizations. The way they receive money is changing everything. Investors must assess deals from multiple angles, considering how regulatory and reimbursement changes will affect the financial structure, the clinical structure, the IT structure and insurance contract structures.

Complicating matters, many of these initiatives will be undertaken by newly partnered entities, each bringing their own relationships, billing and IT systems, team members and culture, debt structures and physical plant assets to the table. Decisions on how to change must be done in the context of what to keep or sell in order to best prepare the organization for a future that may look quite different from its present.

A Look Inside One Payment Change Reveals the Complexities

The Centers for Medicare and Medicaid Services (CMS), one of the biggest insurance payers in the marketplace, is a tremendous force for change that is aggressively pushing value-based models that align payment with quality



of care. Mandatory bundled payments are one of the newest CMS initiatives on the table. In early April, CMS rolled out its [Comprehensive Care for Joint Replacement Model](#), holding hospitals responsible for all costs, processes and outcomes for Medicare hip- and knee-replacement patients within 90 days of their initial hospitalization. CMS sets a target reimbursement rate—if the total cost of care is below that, the hospital earns an incentive. This is more than just a reimbursement change.

To successfully keep costs below the target rate, hospitals must not only manage in-patient care, but also take on responsibility for care that happens outside of its walls. Where the hospital sends patients to recover isn't simply a cost factor; it's also a quality factor. If a patient receives poor care and ends up getting readmitted to the hospital, that's a

Continued on the following page...

Value Based Payments...Continued

huge setback that drives costs up quickly.

For investors eyeing the market, this move raises important questions. How are post-acute care providers positioned in hospitals' networks? Where are the biggest referral sources for their business, and how might that change as reimbursements evolve? How do they fare—both in terms of cost and quality of care—against peers in the region? What can be done to improve a facility's quality of care?

Enormous amounts of capital have been deployed into skilled nursing facilities over the years, with many highly leveraged. With the shift to value-based payments and "site neutrality" to demonstrate same or better outcomes at lower costs, the entire continuum of care will face intense pressure to adjust operations and invest capital wisely for this new era of healthcare. The current mispricing of healthcare assets and increasingly inefficient capital allocation can only be resolved with repricing and restructuring.

Bundled payments may seem like one minor payment initiative in the grand scheme of things, but CMS actions are often mimicked by commercial insurance payers. Closely monitoring new initiatives CMS introduces into the market can give you some insight into where the rest of the market will soon be headed. And more bundled payment initiatives are likely on the horizon.

The New, Comprehensive Inspection Complicates the "To-Do" List

Many restructurings in the healthcare space have been essentially recapitalizations of balance sheets with new debt. These restructurings were ultimately unsuccessful as the process did not correct the underlying causes that created the need for restructuring in the first place. Transformation in the context of such systemic change demands a 360-degree look at myriad integrated, moving parts.

Clinical Structure

New alliances among care providers

demand a new set of care protocols. Data analytics will play a greater role as networks narrow and providers are better able to stratify patient populations based on the care they consume and deploy supplemental resources to high-cost, high-utilization cohorts.

These efforts, in turn, will require development and oversight by an aligned clinical team that is committed and empowered to adjust protocols to reflect rapidly evolving medical advancements.

Restructuring a clinical structure might include any or all of the below, or more:

- ▶ Exploring strategic alliances or acquisitions to expand the care network—including comprehensive inspections of each entity's own clinical, financial, operational and risk structures
- ▶ Considering hospital-at-home programs to prevent low-level admissions
- ▶ Building a strategy to determine the appropriate acuity level for each facility
- ▶ Developing and implementing clinical practice guidelines
- ▶ Stratifying the patient population based on level of care consumed
- ▶ Evaluating and monitoring 30-day readmission rates
- ▶ Conducting medication reviews
- ▶ Reviewing utilization management
- ▶ Evaluating screening protocols

Operational Structure

Who does what in this new world, with what tools, and where? If you've acquired a new facility, do you need an old one at all, or do you need it to play a different role in your network?

Operations evaluations include examination of electronic medical record technologies, interoperability needs and data collection optimization. It also demands analysis of physical plant needs—is each facility in the right location for the population it needs to serve? Are the rooms big enough for larger computer monitors to accommodate doctor-patient discussions of medical scans? Is there space for clinicians to hold

private telehealth consultations?

Workforce and governance, too, will be examined. Clinician roles must evolve, and new roles will be defined, as telemedicine is incorporated into care delivery, as behavioral health is increasingly co-located with primary care, and as community coordinators and social services personnel are better integrated into overall population health initiatives.

Risk Structure

These new provider alliances, care protocols involving new technologies and data analytics programs demand a close look at clinical, financial and regulatory risk.

A comprehensive restructuring will take a close look at every contract among vendors and providers. It will examine current and potential relationships in the context of potential violation of anti-kickback statutes. It will look at current measurement and coding protocols and metrics, as well as the "tone at the top"—leadership's unwritten expectations, which can, in their urgent pursuit of financial stability, inadvertently encourage record manipulation that impacts reimbursements and could trigger a fraud investigation. Mock audits should be a part of the close examination of an entity's risk.

Restructuring takes a close look at the actuarial risk of any owned health plans, as well as vendor insurance programs such as cybersecurity insurance or property insurance.

Financial Structure

As organizations change, their debt structures, too, must evolve. Broadly, restructuring will impact an entity's credit rating (as does, inevitably, the shifting landscape itself). Profile characteristics such as days in accounts receivable will reflect new realities as new billing protocols accommodate, for example, shared risk arrangements. Days' cash on hand, too, will change as outdated cash flow models transition to new ones. Care must be taken, in all restructuring endeavors, to monitor debt covenants to

Continued on the following page...

Value Based Payments...Continued

avoid (or, if violation is the better choice, to manage) covenant violations.

If renovations have increased the useful life of a facility, amortization should adjust to reflect that. New partnerships may necessitate new funds, which might be sourced via alternative structures such as real estate investment trusts, which in turn

carry their own new risks. Debt financing options that may have been “go-tos” before, such as tax-exempt bonds for nonprofit hospitals, may not be the most efficient structures for complex new organizations that combine nonprofit and for-profit services.

Conclusion...

Successful healthcare turnarounds will

increasingly require this “total package” approach to rebuilding a clinical, operational, financial and regulatory infrastructure that will thrive in the new reimbursement environment. Those with capital and a keen understanding of the forces reshaping the ground on which they stand will have a multitude of restructuring opportunities available to them.

WHO ARE THE RISING STARS IN PRIVATE EQUITY HEALTHCARE ROLLUPS?

THE ROLLUP OPPORTUNITIES IN THE WINGS

Segment	U.S. Revenues (\$ Billion)	No. U.S. Offices	% of facilities run by 20 largest organizations	Revenue of 20 largest organizations as % of total revenue
Outpatient care centers	\$98.4	34,752	18.9	31.5
Physical and occupational therapists	\$21.9	28,370	15.5	23.6
Home healthcare	\$65	30,139	10	21.4
Diagnostic imaging centers	\$16.7	6,809	8.5	18.7
Outpatient mental health and substance abuse	\$14.4	9,629	5	9.6
Ambulatory healthcare services	\$814	582,948	2.2	9.3
Dentists	\$104	133,321	2.7	4.7
Optometry	\$12.1	21,561	1.7	3.9
Chiropractic offices	\$11.4	38,796	0.3	1.8

Source: U.S. 2012 Economic Census, released Spring 2016

Rollups are the movement of the moment for healthcare investors. Private equity firms eager to capitalize on highly fragmented specialty markets are looking for rising stars in high-demand areas, hoping to uncover greater efficiencies and drive growth by bringing traditionally independent businesses together into more efficient, effective troupes.

As investors seek out niche areas of growth, they're eyeing opportunities in segments where there are few large players and plenty of room to gain market share. Behavioral health services and dermatology have held the spotlight for some time. And for some of the same

reasons that these segments continue to perform, other rollup opportunities will soon take the stage. We anticipate—and are already seeing—a wave of opportunities in optometry, dental, imaging and other fragmented practices with ancillary business components. Those that understand the market potential and the threats and promises inherent in the new ways healthcare is paid for will be able to capitalize on these rising rollup stars. Even after years of consolidation among the above segments, opportunities remain for those that can sustain a repeatable model for identifying market and location, physician retention, systemization and operational

performance improvement.

Setting the Stage

Physicians are still coming to grips with the massive upheaval that regulatory changes brought to the industry in recent years. Administrative, reimbursement and regulatory pressures—MACRA, MIPS, electronic health record requirements and the complexities of clinical integration—have diminished the appeal of solo practices, which are less able to surmount such challenges than large facilities with more resources. It is possible that under MACRA, many physician

Continued on the following page...

Who Are the Rising Stars... Continued

practices will not be able to meet the requirements. We estimate that practices with less than 25 physicians will have the greatest difficulty and are projected to be penalized under MIPS. This may create additional opportunities for integrations and larger multidisciplinary practices.

Younger physicians entering the workforce have different expectations than in the past. Only 2 percent of residents prefer a solo setting as their first practice, and 92 percent favor a salary over independent practice income, according to Merritt Hawkins' 2015 Final Year Medical Residency Survey. The survey also confirms that most residents are unprepared to handle the escalating complexities of running a medical practice—39 percent of residents said they are unprepared to handle the business side of medicine, and 56 percent receive no formal instruction during their medical training regarding medical business issues such as contracts, compensation arrangements, compliance, coding and reimbursement methods.

The Plot Thickens: A closer look at dermatology

Investors recognize they can provide value in both managing these businesses and bringing disparate pieces together to realize greater administrative efficiencies. They're also closely examining the ancillary opportunities and the reimbursement and compliance issues particular to individual service lines in ever more in-depth due diligence efforts that provide 360-degree clinical, financial and operational pictures.

Dermatologists, like psychologists on the behavioral health side, are in high demand and short supply. The American Cancer Society reports melanoma skin cancer cases will exceed 76,000 cases this year, up from 73,000 in 2015; non-melanoma cases exceed 3.5 million annually. In addition, new revenue streams continue to open in dermatology as cosmetic procedures and laser services, such as tattoo removals, rise in popularity. Data provider IBISWorld reports the dermatology industry generated \$12.7

billion in 2015 and will climb to \$16.3 billion in 2020.

Another attractive feature: nearly all of this work is done in an outpatient setting, which translates to lower costs for patients and ancillary real estate opportunities for investors. The reimbursement environment increasingly favors high quality, low cost settings—a key factor that commercial and government payers use to determine whether to keep providers in-network. Dermatologists also tend to have a higher out-of-pocket business than other medical specialties, which reduces some of the billing complexities and provides investors more predictability for revenue forecasting.

Real estate consolidation holds promise in dermatology (and select other segments), as does building out the business through ancillary services, such as labs and surgery centers. For private equity investors, it is these ancillary services (imaging, lab, pharmacy, etc.) and their technical fee components that drive much of the investment return. A few transactions highlighted by peHub in recent months include:

- ▶ New Mainstream Capital's portfolio company Anne Arundel Dermatology Management acquired Maryland-based Montgomery Dermatology Associates LLC in May to expand its presence in Maryland; its third acquisition since June 2015.
- ▶ Varsity Healthcare Partners' portfolio company Forefront Dermatology, one of the five largest dermatology practices in the U.S., acquired Premier Dermatology, based in Crest Hill, Ill., in November 2015, to continue its expansion; its footprint extends across nine states. In February, OMERS Private Equity acquired Forefront Dermatology.
- ▶ LLR Partners provided \$35 million in financing in April to Schweiger Dermatology Group, LLC, which it manages, to support its continued acquisition strategy in the New York metropolitan area and to build new locations.

Sharing the Spotlight

Dermatology isn't the only shining star in the business. Investors are looking across the healthcare field to other fragmented areas such as dentistry—a segment in which, according to the latest U.S. Economic Census data, the 20 largest organizations controlled only 4.7 percent of a \$104 billion market (see chart). For example, Chicago Pacific Founders raised \$35 million to launch dental support organization Marquee Dental Partners in October 2015. Since then, it has acquired three dental practices across the Mid-South region of the U.S.

Like dermatology, the dental segment operates as a more cash-like business, with most payments made out of pocket, which provides investors more revenue transparency than, for example, oral surgery practices, which are more typically reimbursed by health insurance companies.

We are also seeing an increase in investor interest in physical therapy, imaging centers and other less-risky specialties typically performed in stand-alone facilities outside of the hospital, where investors have opportunities to leverage the physical plant. The chart above illustrates several specialty segments in healthcare where there is opportunity for large players to capture a bigger slice of the market. The data, released in spring 2016, reflects information from 2012. Much has happened in the way of rollups and M&A in the meantime, but many opportunities remain. Uncovering them requires a thorough understanding of the dynamics in play within each segment. What lies beyond these numbers?

The complexities of healthcare, even in the seemingly lower-risk reimbursement areas highlighted in this article, are not for investment dabblers. Reimbursement risk as well as the myriad regulations governing healthcare can create problems quickly. In particular, management companies must carefully heed corporate practice of medicine doctrines that many states have in effect, which carefully detail where certain income sharing is

Continued on the following page...

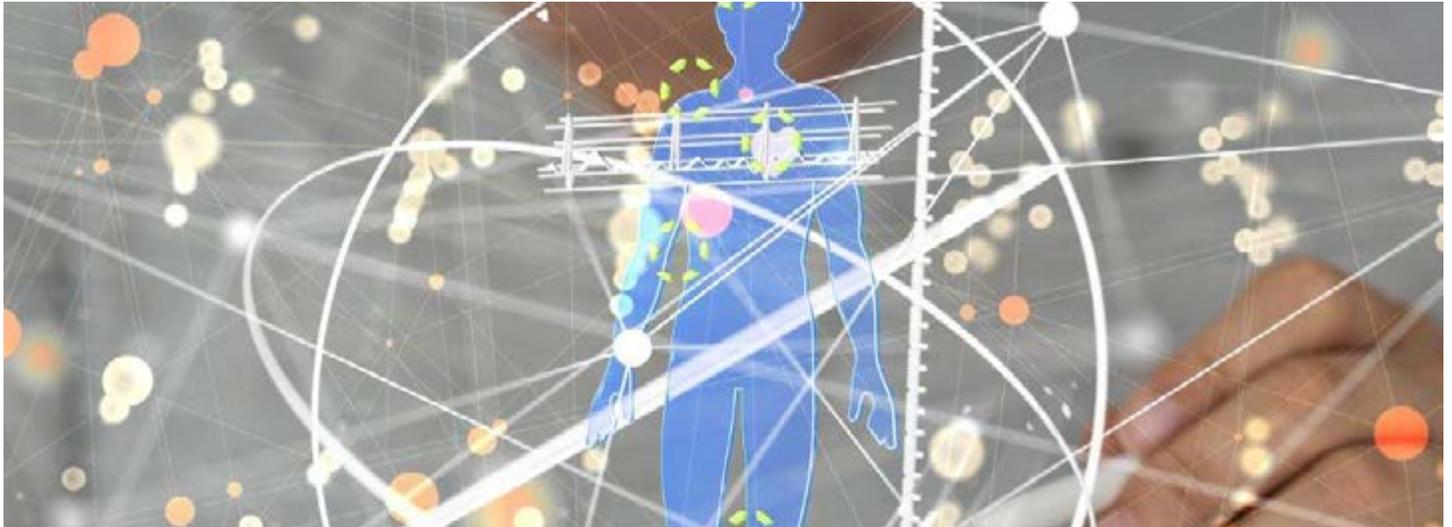
Who Are the Rising Stars... Continued

strictly off-limits. These laws make clear that corporations in some states are not allowed to profit from physicians seeing patients, so the proper structures must be put in place to ensure that the

efficiencies that are realized come from the “business” side of managing the operations and from ancillary services.

Investors should proceed with extreme caution in arranging the proper deal

structure, physician compensation programs and in considering where resources can be appropriately (and legally) pooled.



PERSPECTIVE IN HEALTHCARE: A FEATURE EXAMINING THE ROLL OF PRIVATE EQUITY IN THE HEALTHCARE INDUSTRY

Private equity interest in the behavioral health sector has surged in the last couple of years. With an opioid addiction crisis boosting demand for addiction treatment centers, and the Mental Health Parity and Addiction Equity Act of 2008 and the Affordable Care Act of 2010 combining to put health insurance coverage within reach of many more affected individuals, investment firms have seen an opportunity to build value and increase accountability in an extremely fragmented system.

Strategic and financial acquirers have been active in the sector, driving consolidation as investors seek roll-up deals to create larger platforms with increased synergies. New Mainstream Capital acquired Constellation Behavioral Health in May 2016, and plans to build upon that platform with a combination of de novo startups and strategic acquisitions, according to a press release. In January 2016, North Castle Partners acquired Turning Point, which offers 92- to 360-day treatment programs for

addiction and recurring mental illness. And in December 2015, Deerfield Management Company invested \$231.5 million in Recovery Centers of America to fund the development or purchase of eight treatment centers in North America, potentially adding 1,200 inpatient beds by the end of 2017, according to *The Wall Street Journal*

Behavioral health-related technology and apps are also drawing interest from private equity firms and other investors hoping to round out their healthcare portfolios. In October 2015, Lyra Health raised \$35 million in a Series A funding round led by Greylock Partners, to fund screening tools that help identify employees with mental health and substance abuse issues, match them to the most appropriate treatment, and track their progress and outcomes over time. Mental health startup Lantern, which provides tools to deal with stress, anxiety and body image, raised \$17 million in a Series A funding round led by the University of Pittsburgh Medical

Center's venture arm, according to *TechCrunch*.

Thanks to the growing use of electronic health records (EHR) among mental and behavioral health providers, as well as a plethora of cognitive therapy-related smartphone apps, the behavioral health software market is expected to reach \$1.5 billion by 2019, up from \$0.75 billion in 2014, according to market research firm MarketsandMarkets.

EHR software helps integrate medical and physical health records, enabling physicians to provide more holistic care. Web-based and smartphone apps can broaden the availability of mental health and addiction care, particularly in underserved areas and among people with limited health care coverage, as well as provide ongoing support for patients at the tail end of recovery. Demand for apps is high, and several tools have demonstrated positive outcomes in clinical trials, although many lack scientific evidence of their efficacy, according to

Continued on the following page...

Perspective in Healthcare... Continued

the *Journal of Medical Internet Research*. There are at least 800 smartphone apps oriented around mental health and cognitive behavior; but quality varies greatly, and all tools struggle to achieve long-term engagement, something that is crucial to long-term success, according to the *International New York Times*.

Investing in behavioral health-related technology can add value to a PE firm's healthcare portfolio. But for those tools to be successful, acquirers should make sure they have a proven track record and form a part of a holistic treatment offering aimed at enhancing traditional professional care.

**Future Perspectives:
Healthcare Investing Outlook**

Overall healthcare services deal volume slipped slightly in Q1 2016, signaling that investors may be feeling fatigued after a record-setting 2015, and a slowdown in deal activity may be on the way, according to *Health Care M&A News*. However, M&A activity in the behavioral health sector remains steady. The first quarter of 2016 saw eight behavioral health deals, compared to the same amount in Q1 2015, highlighting the continued importance of the sector. Additionally, *Behavioral Healthcare* reports that due to the increasing significance of mental health and substance abuse treatment

services, providers will look to M&A to build either greater scale or niche services to remain competitive. And as a result, they may focus on strategic investments in technology. Still, regulatory uncertainties are on the horizon for substance abuse and addiction treatment centers, as state regulators and insurance companies quickly adapt to the sector's rapid growth in significance, *Behavioral Healthcare* goes on to report. Investors will look to those companies that are already operating well within regulation and compliance.

Sources: *Behavioral Healthcare, Duff & Phelps, Healthcare Dive, Healthcare IT News, Healthcare M&A News, MarketsandMarkets, Medical News Today, New York Times, NPR, TechCrunch, The Wall Street Journal.*

DID YOU KNOW?

A hospital's location matters a lot when it comes to how many of its doctors accept payments from pharmaceutical and device makers, according to recent [analysis](#).

Healthcare organizations are quickly becoming more receptive to cloud technology. But 80 percent are hesitant because of security and data privacy concerns, a recent [survey](#) of almost 160 CIOs revealed.

Healthcare providers and opinion leaders have different understandings of biosimilars: 36 percent of the former say

they are "very" similar, vs. 15 percent of the latter, a [report](#) revealed.

Healthcare spending from 2015-2025 is projected to grow 1.3 percent quicker than GDP per year, pushing the health share of GDP to an expected 20.1 percent, [CMS data](#) show.

Projected national healthcare spending, though faster this year than recent years, is slower than it was in the two decades leading up to the Great Recession, the [CMS data](#) show.