MARWOOD GROUP

Growth And Consolidation In The Substance Use Disorder Treatment Space

Executive Summary And Outline

The growth in demand for substance use disorder (SUD) treatment is likely to continue even if the economy enters into a recession. Beyond the epidemiology of substance abuse during recessionary periods, Federal legislation and state Medicaid policy remain consistent tailwinds to the industry. However, care must be taken in modeling commercial payor revenues, where an industry shift in-network and the risk of high deductibles have added pressures to profitability. Herein we address the key tailwinds and challenges to this industry which has seen significant investor interest.

I. Substance Use Disorder Remains A Persistent Problem, Post-Pandemic

The COVID-19 pandemic and its toll on the country's mental health, along with lockdowns which reduced physical access to treatment, exacerbated the addiction crisis. Addiction experts believe the impacts will be long-lasting. An estimated 40.3 million people over age 12 in the United States have a SUD, according to Substance Abuse and Mental Health Services Administration's most recent study. Alcohol remains the leading abused substance, followed by opioids and painkillers, according to addiction experts. Approximately 4.2 million people receive help in a given year. The Centers for Disease Control and Prevention reported 100,306 drug overdose deaths in the U.S. in the 12 months ending in April 2021, the highest number ever recorded in a 12-month period and a staggering 28.5% increase from the year previous.[1]

II. A Fragmented Industry

The SUD treatment industry remains highly fragmented among over ~16,000 facilities. Private for-profit organizations operate ~41% of facilities and this share has been increasing.[2] Indeed, the SUD treatment space has shown ample room for consolidation with brisk deal flow over the past 18 months (Figures 1 and 2). The last 18 months have shown a continued aggressive national growth strategies by existing SUD/behavioral health companies (Table 1). In addition, there has been continued

[1] CDC/National Center for Health Statistics, November 17, 2021.
[2] Department Of Health and Human Services, Substance Abuse and Mental Health Services Administration, 2020.

investment by private equity investors in the sector (Table 2). Together, these tables represent a mere snapshot of a larger M&A landscape in SUD treatment and behavioral health overall.

Acquirer	Acquirer Description	Locations	Target	Target Description	Closed
Acadia Healthcare *(Publicly traded)*	Founded in 2005; based in Franklin, TN	238 locations; 40 states and PR	CenterPointe Behavioral Health System	Incorporated in 2015; based in Saint Charles, MO	Dec-31-2021
BayMark Health Services Inc. *(Webster Equity Partners, LLC)*	Founded in 2008; based in Lewisville, TX with additional locations across the United States and Canada.	100+ locations	San Antonio Recovery Center	Incorporated in 2002; based in San Antonio, TX	Jul-26-2022
			Pathfinders Recovery Center; Emerald Isle Health and Recovery	Pathfinders Recovery Center has locations in Scottsdale, AZ and Aurora, CO; Emerald Isle Health and Recovery is located in the Surprise, AZ area	Mar-04-2022
			Kaden Health, Inc.	Founded in 2018; based in NY; virtual treatment services for opioid use disorder	Jan-05-2022
			Riverwood Group, LLC	13 programs across 7 states	Dec-23-2021
			Granite Recovery Centers LLC	Founded in 2008; based in Salem, NH	Dec-21-2021
			Polaris Renewal Services in Western PA	Two locations in western PA	Dec-21-2021
Discovery Behavioral Health *(Webster Equity Partners, LLC)*	Incorporated in 1993; based in Los Alamitos, CA with an additional office in Dade City, FL	100+ locations	Brookdale Premier Addiction Recovery	Located in Scotrun, PA	Aug-10-2022
			Anew Era TMS & Psychiatry, Inc.	Incorporated in 2002; based in Huntington Beach, CA	Jul-18-2022
			Prevention and Recovery Center, Inc.	Founded in 1982; based in Houston, TX	Aug-18-2021
Behavioral Health Group *(The Vistria Group, LLC)*	Incorporated in 2002 and based in Dallas, TX with additional offices in CO, AK, DC, KS, GA, VA, KY, LA, MO, TN, TX, SC, NC, AL	50+ locations	Center for Behavioral Health	Founded in 1983; based in Boise, ID	Jan-13-2022
			Four Valhalla Place Opioid Treatment Program	4 locations	Nov-04-2021
			Staunton Treatment Center/ BHG XLII, LLC	Incorporated in 2013; based in Staunton, VA	Nov-04--2021

Table 1: *Select platform transactions in the SUD treatment space over the past 18 months*

Acquirer	Target	Target Description	Locations	Prior investors	Closed
Patient Square Capital	Summit Behavioral Health	Founded in 2013; based in Brentwood, TN with additional locations in CA, MO, GA, PA, LA, SC, and TX	50+	Edwards Capital, LLC FFL Partners, LLC Flexpoint Partners II, L.P., Lee Equity Partners, LLC Northwood Healthcare Partners	Nov-24-2021
FFL Partners & Two Sigma	Community Medical Services	Founded in 1983; based in Scottsdale, AZ with additional locations in AZ, TX, CO, AK, MT, ND, MN, MI, IN, OH	45+	Clearview Capital Fund III LP Clearview Capital, L.P.	Dec-15-2021
Amulet Capital	Lighthouse Behavioral Health Solutions	Incorporated in 2018; based in Columbus, OH with additional locations in OH	15+	-	Mar-30-2022
The Vistria Group, LLC	Sandstone Care	Incorporated in 2015; based in Denver, CO	10+	-	Jul-21-2022
Onex Corporation	Newport Healthcare	Monroe Operations LLC, (DBA Newport Healthcare) founded in 2008 and is based in Nashville, TN	10+	-	Jun-7-2021

Table 2: *Select private equity transactions in the SUD treatment space over the past 18 months*

III. Federal Policy Tailwinds

The industry benefits from a favorable federal legislative and regulatory environment. Over the past decade or so, Congress has passed several pieces of legislation that expanded coverage for substance use disorder (SUD) treatment, improved mental health parity with other physical health services and allocated funding for treatment:

- **The Mental Health Parity and Addiction Equity Act (MHPAEA)**, passed in 2008, required group health plans (with at least 51 employees) to administer benefits for mental health/substance use disorder (MH/SUD) treatment on the same par as with medical/surgical health coverage.
- In addition to extending MH parity to the small group and individual markets, the **Affordable Care Act (ACA)** positively impacted the MH/SUD industry in other ways, such as providing for the expansion of Medicaid in certain states to individuals with incomes up to 138% of the federal poverty level; expanding coverage to additional individuals and small businesses through healthcare exchanges/Marketplaces and designating MH/SUD as an essential health benefit in Marketplace plans; and including coverage for adults up to age 26 on their parents' insurance.
- **The Comprehensive Addiction and Recovery Act (CARA),** signed into law (2016), expanded prevention and education efforts while also promoting treatment and recovery. The 21st Century Cures Act (2016) allocated $1 billion to support the state demonstrations authorized in CARA as well as reauthorizing or creating other funding sources for treatment.

- In 2018, the Senate passed the **Substance Use Disorder Prevention that Promotes Opioid Recovery and Treatment for Patients and Communities (SUPPORT) Act**, which extended Medicare coverage to medication assistance treatment and expanded federal Medicaid reimbursement for IMD services for SUDs for up to 30 days per 12-month period. Additionally, under the SUPPORT Act, the federal government required that state Medicaid programs cover all drugs approved for medication assisted treatment, from October 1, 2020, through September 30, 2025.

IV. Medicaid And State Policy Tailwinds And Headwinds

Medicaid is the country's largest payor for SUD treatment. According to Medicaid's SUD behavioral health services page, nearly 12% of all adults enrolled in Medicaid have an SUD.[3] State Medicaid programs are required to cover substance abuse treatment for their ACA expansion enrollees. As of September 2022, 38 states have expanded Medicaid under the ACA. States are not required to provide SUD coverage for non-expansion enrollees, however nearly all states do provide some SUD coverage for these enrollees. The extent of coverage can vary considerably. For example, states enhance access to SUD treatment through non-Medicaid funding to providers. States also have mental health parity laws and some, such as California, have increased them.

State policies on certificate of need and licensure can restrict SUD providers from expanding their services into other states. There has been a trend of state Medicaid programs implementing Medicaid managed care with managed care plans being allowed to implement utilization management tools, most notably prior authorization, across covered services including SUD treatment.

V. Commercial Payors React To Demand And Legal Challenges

States, along with the federal government and private litigants, alarmed at record overdoses year after year, have demanded that payors adhere to mental health parity laws. Recent mental health parity lawsuit settlements (including UnitedHealthcare, Aetna, and Anthem) have led to some payor moderation relative to utilization management focus on behavioral health / addiction treatment services.

However, the sector has, in recent years undergone significant structural changes as private healthcare payors began to scrutinize expensive out-of-network treatment, challenging the business model upon which much of the private addiction treatment centers were initially built. Thus, there are fewer fully out-of-network addiction providers around today, with providers reporting lower margins, but more reliable, in-network payments. While this remains the shift payors desire to encourage, adequate in-network access remains a challenge, particularly in underserved urban and rural areas. Concurrent to getting tough on claims, payors have also been turning their attention to addiction treatment outcomes. Aetna, for example, invested $50 million in MAP Health Management of Austin, which offers outcomes-based solutions to addiction treatment providers.

[3] Medicaid.gov *accessed October 2022.*

VI. Economic Conditions – A Double-Edged Sword

A recession may increase the number of patients requiring help as individuals struggle to cope with the stressors of economic uncertainty and unemployment/underemployment. Peer reviewed studies have furthered the connection between recession and substance use. A recent study in the U.S. based on self-reported data found that economic downturns led to increases in the intensity of prescription pain reliever use as well as opioid substance use disorders. Unemployment was associated with substance abuse admissions for alcohol, marijuana, opiates, cocaine, and other drug use.[4]

However, patient-payor dynamics in periods of recession are not straightforward. While recessions typically lead to unemployment which can increase exposure to Medicaid or even uninsured care, the growing application of high deductible health plans (HDHPs) over the past decade has changed the willingness to seek care of those who retain their coverage; especially relative to prior downturns. The share of workers enrolled in an HDHP with a savings option grew from ~8% in 2009 to ~28% in 2021, according to data from Kaiser Family Foundation. High deductibles chip away at the buffer that historically has helped guard much of the healthcare sector against a recession's slowdown on consumer spending. For example, if a consumer has a $10,000 deductible, they're more likely to entertain choices of whether treatment is urgently needed or if it can wait. Investors and providers run a risk of missing “traps” in the revenue cycle, namely instances where patients are unable to pay their deductible at the beginning of a 20- to 60-day program. This risk would likely be aggravated by recession.

Concurrently, labor shortages are expected to remain a challenge. The U.S. does not have nearly enough mental health and addiction treatment professionals to treat the afflicted population. Already, more than 150 million people live in federally designated mental health professional shortage areas. Within a few years, the country will be short ~31,000 psychiatrists; psychologists, social workers, and other behavioral health professionals will be overextended.[5] In addition, the gap between need and access will remain especially acute care deserts and in particular, rural areas. Notably, more than half of U.S. counties lack a single psychiatrist.

Finally, the level of inflation pressures providers that may not be able to adjust reimbursement to adequately compensate for rising costs. A consideration we evaluate in Marwood’s whitepaper on the impact of inflation on healthcare services from March of this year.

VII. Future Considerations

Target analysis in this environment requires an understanding of health plan cost control strategies and emerging federal and state regulatory and legislative policies impacting coverage, utilization, and reimbursement. Experienced in the behavioral health space, Marwood’s services span federal and state regulatory and legislative considerations and payor/PBM dynamics from a Medicare, Medicaid and commercial perspective. In addition, Marwood’s analysis covers strategic considerations including market sizing, growth outlook, referral source views, competitive landscape, and compliance.

[4] Wolfson M et al. (2021). Unemployment rate, opioids misuse and other substance abuse: quasi-experimental evidence from treatment admissions data. BMC Psychiatry 21:22.
[5] A growing psychiatrist shortage and an enormous demand for mental health services. Association of American Medical Colleges. Aug 9, 2022.

ABOUT THE AUTHORS

Mark Slomiany PhD MBA MPA is a Director of Advisory at The Marwood Group and a former faculty member of the Department of Cardiothoracic Surgery at New York University Langone Health, as well as a former research associate at the Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School of Government.

Deborah Freier is a Senior Vice President at The Marwood Group and has been with the firm since 2017. Prior to joining Marwood, Ms. Freier served in senior strategic planning and operational roles at managed care plans as well as a research associate at Harvard Business School. Ms. Freier holds a Master of Business Administration from The Wharton School.

ABOUT MARWOOD

Marwood is a leading healthcare advisory, strategy, and research firm that provides comprehensive depth, perspective, and insight to financial sponsors, lenders, healthcare companies, asset managers, and others. We are seasoned professionals from government, industry, academic medicine, healthcare consultancies, and finance with a deep understanding of the influence federal and state policy and politics has on reimbursement and regulation—and how those levers impact business strategy and investment decisions.

For more information on the content in this publication or to learn more about Marwood Group Advisory's capabilities, we encourage you to contact us:

Lee Alvarez
Senior Managing Director
Office: 212-532-3651
lalvarez@marwoodgroup.com

Jennifer Meyers
Managing Director
Office: 212-532-3651
Jmeyers@marwoodgroup.com

Kyle Holmes
Senior Vice President
Office: 212-532-3651
kholmes@marwoodgroup.com

Joshua Benig
Vice President
Office: 212-532-3651
jbenig@marwoodgroup.com