

Customer & Market And Operational Due Diligence Of Leading Private Pay Residential Mental Health Services Provider: Establishing Program-Level Competitive Positioning And Operating Performance

The Challenge: One of our long-time PE clients was looking to acquire a leading multi-program player in the high-end residential treatment market, serving adolescents and young adults with a broad array of behavioral disorders. While the target has been growing, our client was concerned about the target's competitive positioning and recessionary risk. Furthermore, the target's performance varied across the programs as it has grown by adding programs, both de novo and through acquisitions. So, our client asked Gotham to conduct a Customer & Market and Operational due diligence of the target to: (1) understand the market dynamics and growth outlook; (2) establish the target's competitive positioning and reputation with the referral network; (3) assess operational performance and recessionary risk; and (4) determine the operating model that would enable the target to leverage scale.

2-Phased Approach To Understand Overall Opportunity And Program Level Levers: Gotham structured a 2-phased due diligence effort: Phase I to understand the overall market and referral dynamics of the adolescent mental health services market, and establish the target's overall competitive positioning and growth opportunity; and Phase II to assess the target's programs, including operating performance, competitive positioning, and recessionary impact. To this end, Gotham:

- Conducted 43 interviews with referral sources, competitors, and industry experts to understand referral dynamics, program selection criteria, and the target's reputation and competitive positioning
- Developed a comprehensive database of private pay residential treatment programs for adolescents and young adults and created detailed profiles of all multi-program competitors
- Built a bottom-up market sizing model to establish size and growth rates of the target's market
- Built detailed fact packs for each of the target's 10+ programs to enable a substantiate performance review with the management
- Assessed potential operating models for gaining scale leverage and reviewed de novo vs. acquisition models.

\$900MM Adolescent Private Pay Residential Treatment Market Expected To Grow At 9+% CAGR

Navigating through complex market dynamics, Gotham established that the spectrum of care for adolescents ranged from counseling at school for less-intense mental health disorders to residential treatment for more severe disorders, after all local options such as outpatient therapy, intensive outpatient program (IOP), partial hospitalization program (PHP), and inpatient hospital stay have been exhausted. Gotham established that out of the ~25MM adolescent population, ~20% suffer from mental health disorders, including ~1.4MM adolescents with severe disorders. Based on severity of disorder, willingness to seek residential treatment, and funding sources, we modeled that <100K adolescents seek residential treatment and, of these, ~10% would seek treatment at private pay facilities, representing a \$900MM market. We estimated that the target's market will grow at 9+% CAGR driven by increasing access to mental health care and changing insurance dynamics due to mental health parity laws.

Target Is Well-Positioned In A Fragmented Market With Changing Referral Dynamics

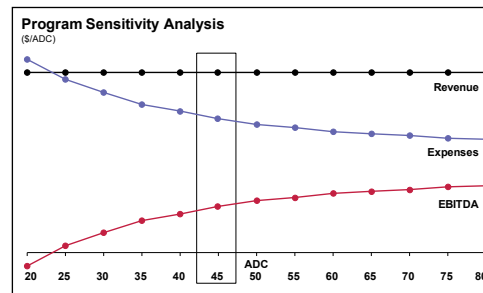
Gotham's detailed competitive landscape assessment indicated that the target's market is very fragmented, with 54% of the market served by single-location players and the target being the largest of the multi-program companies. Our interviews confirmed the target's strong reputation, with a number of its programs among the top-rated programs both overall and for the most critical referral criteria. While educational consultant referrals accounted for the majority of the target's business, Gotham established that referral dynamics was changing driven by a growing number of internet leads and clinically-trained educational consultants slowly replacing social worker-type consultants currently prevalent in the industry. This new breed of educational consultants is more business-oriented and metrics-driven vs. traditional consultants who valued individual relationships with therapists, thus positioning a scale player like the target to leverage its sophisticated business practices to gain further competitive advantage.

Scale Leverage Available With The Right Operating Model

To better understand the performance of each of the target's 10+ programs, Gotham: dissected each program cost structure by department, including headcount, fixed/variable, and expense type; developed detailed operational and financial KPIs to benchmark program performance; conducted ROI analysis; established the program's rating by referral sources against 13 criteria; and identified the program's direct competitors and their ratings. We leveraged these detailed facts to develop a new operating model to gain scale efficiencies via centralization of back-end functions and sales/marketing coordination without risking loss from educational consultant referrals.

Recessionary Risk Is Lower Than Initial Indication And Manageable

Based on conversations with Program Directors (both the target's and competitors') and referral sources and available program data on income and sources of funds, we established recessionary risks were manageable, with Average Daily Count (ADC) drop no greater than 10-20%. We modeled headcount reductions based on impact on student inflow and ease of replacement without compromising the quality of care. We built a detailed sensitivity model to determine the program's revenue, headcount, cost structure, and profitability at different ADC levels, which our client incorporated in their own model.



The Outcome: Gotham's comprehensive, fact-based assessment of the target's market and operations allowed our client to gain confidence in the target's competitive position and growth opportunity. Armed with our deep dive assessment of each of the target's programs, our client became comfortable with the recessionary risk and excited about operating model enhancements to leverage scale. This fact-based assessment gave our client the conviction to win the auction with an aggressive bid.