Candesic partner **Dr Michelle Tempest** analyses recent transactions in the mental health sector and discusses the emerging opportunities for investors in a service that is fast coming out of the shadows

Mental Health Matters

for head, heart and wallet

Why does mental health matter?

I guarantee that every reader of this article knows someone, or has suffered themselves with a mental health issue. How can I guarantee that? Well, because mental illness is about as common as the common cold. Every year, one in four people are diagnosed with a mental illness. Yet there is no vaccine and the economic impact of mental illness is around £105 bn – a value approaching our annual NHS budget.

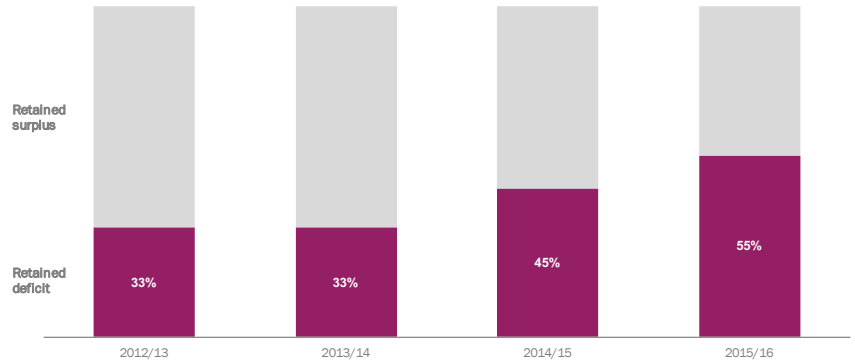
I admit upfront that having worked as a doctor in this sector I retain a dream, a desire and a drive to make it a better service for all who need it. It's a specialty that for far too long has been the Cinderella service and stigmatised. But things are about to change. The future is bright. It is perhaps the hidden gem for brave investors. Mental health has evolved from an understanding that there is no one-size-fits-all approach, plus it's well suited to e-health advancements and the consumerisation of healthcare.

Mental health accounts for 23% of all NHS activity, yet receives only 11% of the NHS budget with over half of NHS Mental Health Trusts being in deficit 2015-16 (Figure One).

Thankfully, the *Five Year Forward View Mental Health* pledged an extra £1bn investment by 2020/21. Plus, mental health made it onto the 2017 agenda of Prime Minister Theresa May who stated: 'Changing [mental health] goes right to the heart of our humanity; to the heart of the kind of country we are, the values we share, the attitudes we hold and our determination to come together and support each other.' She went onto promise another £15m additional funds for community care with more pledges for children's services.

No matter what your political affiliation, it's clear that investment is needed to increase provision as demand escalates in every age demographic, Mental Health Act detentions continue to rise (Figure Two) and social cohesion disintegrates. NHS Mental Health Trust providers will struggle to expand as their remuneration is predominately based on block contracts which fail to reflect demand pressures. Hence, there is a gap in the market for independent providers to answer the call of undersupply.

FIGURE ONE MENTAL HEALTH TRUSTS IN DEFICIT
(% OF MENTAL HEALTH TRUST, 100% STACKED)



SOURCE KING'S FUND; CANDESIC ANALYSIS

Global investment in mental health

The last year highlighted that global money has been pouring into independent mental health provision. There are currently some more deals in the pipeline, but a summary of the major announced deals include:

- Acadia, who already owned Partnerships in Care, bought Priory Group from Advent
- UHS owned Cygnet, invested in Alpha Hospitals adding 3 mental health hospitals to its portfolio,
- UHS went onto acquire the adult services division of Cambian Group in a highly competitive auction, and
- BC Partners bought 22 hospitals from Partnerships in Care and Priory after the Competition and Markets Authority (CMA) forced Acadia to divest. This new group has since been named Elysium.

Aside from the Elysium deal, where Private Equity was the most assured and quickest way to ensure a deal in time for the CMA's deadline, all other deals were done by trade at record multiples. Clearly, American corporates see the UK as the next high growth geography for them (or at least higher than the stagnant US market). This begs the question how will these investments mature and what's their future?

Market segmentation

To get any investment thesis correct, there is a requirement for a deep understanding of this obfuscated market. Would you believe that in 2017 there is no on-line open source for mental health bed provision in our country?

On top of this, just as in physical health, the mental health sector has

subspecialised as treatment gets ever more sophisticated; consequently, to compare like-for-like services, industry experts need to be at hand to guide you through the nuances of subspecialties.

This article would be too long if it covered every subspecialty, so let's take the example of inpatient 'rehabilitation and recovery' where people often stay for around 18 months. These are not drug and alcohol services, not learning disability nor brain injury, but are defined by the Royal College of Psychiatrists as services for people 'living with a longer-term mental health problem' who 'cannot be discharged home'. Usually they include people with a diagnosis of schizophrenia, schizoaffective disorder or bipolar disorder. Typical difficulties include:

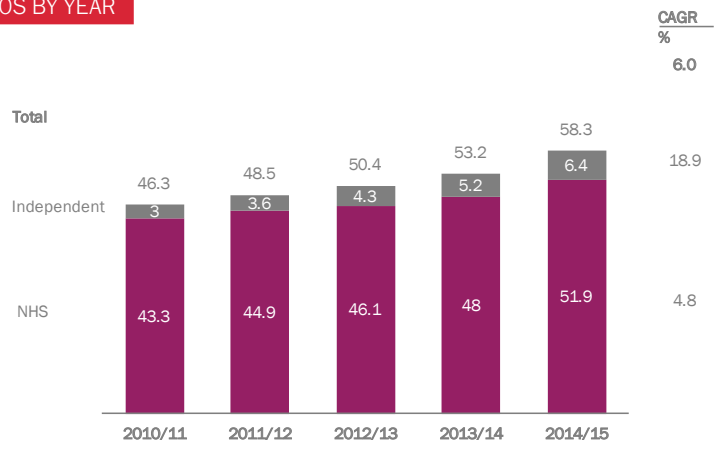
- Problems with organising and planning daily life
- Symptoms of mental illness, such as hearing voices that are distressing or make it difficult to communicate with other people
- Being exploited or abused by others
- Behaving in ways that other people find difficult or threatening, which may have led to contact with the Criminal Justice System.

Rehabilitation and recovery units are almost entirely state funded, yet have plurality of providers, with 49.7% of beds being NHS and 50.3% independent (private and charity).

Figure Three highlights the top independent players are Arcadia (Priory and PiC), UHS (Cygnet and Cambian) and Elysium with a long tail of other providers, highlighting the opportunity for consolidation within this sector. Although, as the saying goes 'once bitten, twice shy' Acadia reminds the sector that consolidation does come alongside the watchful eye of the Competition and Markets Authority (CMA) which monitors to ensure that no single provider controls over 30% of the local market within a 70 mile radius. It's also noteworthy that NHS provision is excluded from any CMA analysis.

It's expected that 2017 will see a race for consolidation of subspecialties and the continued expansion of local care pathways from specialist to community provision, with the obvious synergies and savings for operators who focus on defined care pathways and single service lines.

FIGURE TWO DETENTIONS UNDER THE MENTAL HEALTH ACT 1983, ENGLAND 1,000S BY YEAR



SOURCE INPATIENTS FORMALLY DETAINED UNDER THE MENTAL HEALTH ACT 1983, ENGLAND, 2014-15, NHS DIGITAL; CANDESIC ANALYSIS

Competition in recovery

All providers in this subspecialty compete on quality, occupancy and price.

Quality In the brave new world of outcome based commissioning, prudent providers are developing published evidenced based outcome data, reduced readmission rates and reduced length of stay.

Occupancy Providers, to date, have not had to be overly proactive to fill their units. NHS and independent providers often find they have a waiting list of people either stepping down from low secure units, stepping up from community breakdown or awaiting transfer from an acute ward. The latter number of delayed transfers of care (DTOC) is where providers could get more proactive within their local market, which would come with the blessing of both clinicians and commissioners.

Price Nobody can escape price point. Beds usually get paid for direct from Clinical Commissioning Groups (CCGs) or are sometimes subcontracted from Trusts. The usual arrangements are via:

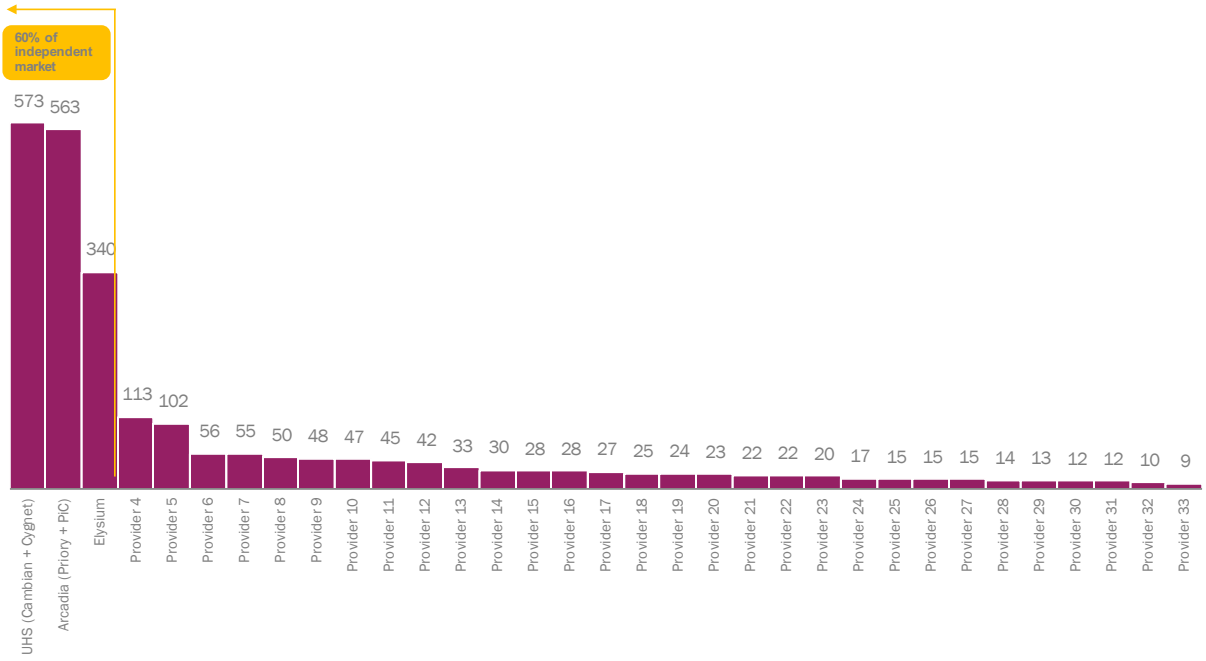
- Spot purchase,
- Framework agreements, block contracts or,
- Service Level Agreements (SLA).

The 209 CCGs have been recently grouped together into 44 STPs (Sustainability and Transformation Plans) and the STPs are focused on keeping prices down and reducing out of area placements.

Having collected price data points from most CCGs for rehabilitation and recovery, Figure Four offers a high level summary. Framework agreement prices

FIGURE THREE PLURALITY OF INDEPENDENT MENTAL HEALTH REHABILITATION PROVISION

Number of independent mental health rehabilitation beds by provider



SOURCE CANDESIC MENTAL HEALTH DATABASE, AUGUST 2016; CANDESIC ANALYSIS

have tended to remain constant year on year, whereas variation is more marked in spot purchase prices. Perhaps this is understandable as spot purchase is done on a case by case basis and no two care plans are ever the same. As for the juxtaposition between NHS and independent providers, it is interesting to note that within this subspecialty the NHS rehabilitation and recovery provider price is consistently benchmarked in the top quartile.

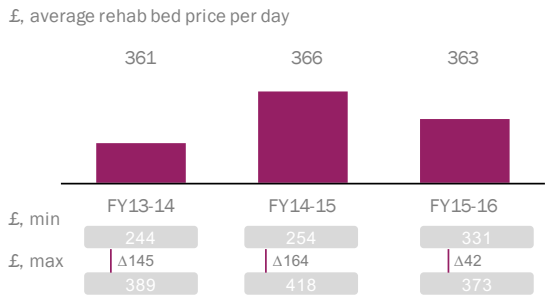
The future

In summary, I am very optimistic for this sector. I believe it will have to be an area where the State and business will and can work in harmony. Further, the market brings a set of strong fundamentals (Figure five). The catalyst for change, however, may come from STPs which will be wanting and needing the independent sector to have the appetite for growth whilst managing to keep price points below NHS rates for subspecialties.

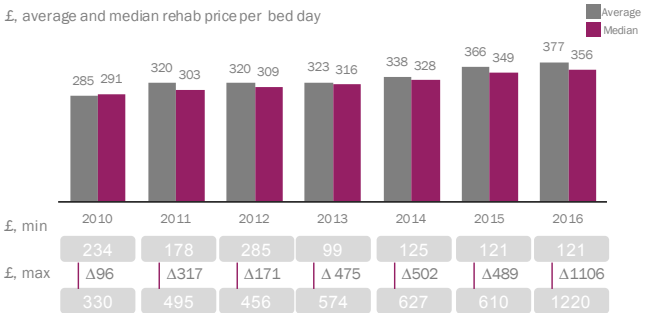
Opportunities include consolidation by acquisitions, buy and build, partnering with NHS Trusts, developing public-private-partnerships, building clear pathways and having the appetite for more risk sharing with commissioners maybe via Accountable Care Organisations. One thing remains sure: anyone investing or operating in this sector must have a heart, a brain and a wallet, and the combination of these three should reap rewards for both improved care and a decent return.

FIGURE FOUR VARIATION IN THE PURCHASE OF MENTAL HEALTH REHABILITATION SERVICES

Within bock contracts, implied average day rates have been relatively stable, variation however exists



Spot purchase has seen a year on year increase, large variations in day rates are observed across CCGs



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