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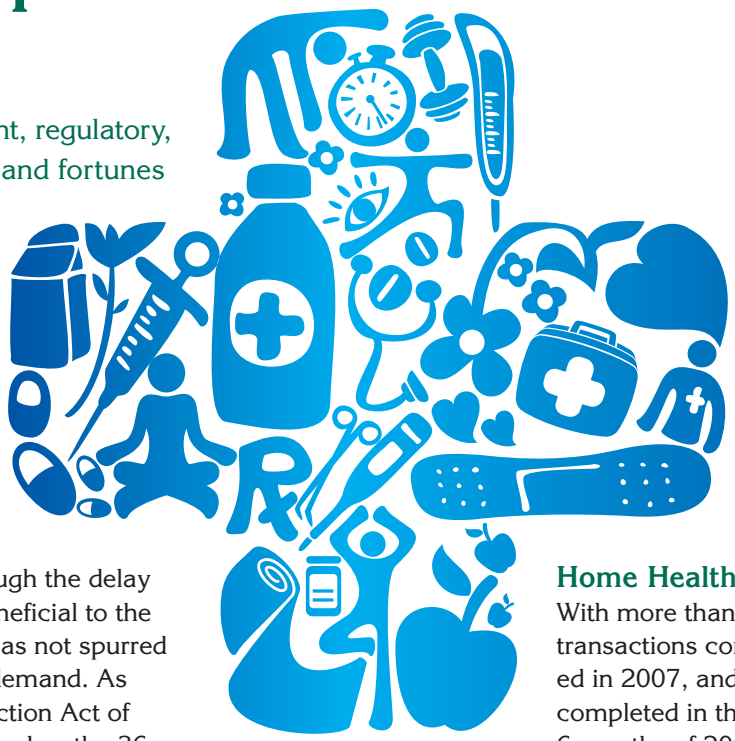
DMEPOS and Home Health
(Hospice Approval Coming Soon)

Home Care Merger and Acquisition Update

by Dexter W. Braff

In an ever-changing reimbursement, regulatory, and investment market, the fates and fortunes of home care providers with respect to merger and acquisition demand, supply, volume – and valuation – is constantly in flux.

Below is a brief roundup of the primary home care sectors, and where they stand in today's M&A market.



Home Medical Equipment. Although the delay in competitive bidding is generally beneficial to the industry, at least as of this writing, it has not spurred any significant up tick in acquisition demand. As we have stated since the Deficit Reduction Act of 2006 was passed, more than anything else, the 36 month cap on oxygen reimbursement – and continued threats by congress to reduce this cap to 18 months or less – has chilled the M&A market to the extent that transaction volume is down more than 70% from the peak 2004-2005 periods. That said, some deals are getting done, including some big ones – notably Teijin Limited's acquisition of Pacific Pulmonary and The Blackstone Group's announced acquisition of Apria. Moreover, when they are getting done, though valuations are down, they have not plummeted as much as the extraordinary reduction in demand might suggest. Accordingly, opportunistic and highly strategic opportunities remain. But unless the aforementioned cap is eliminated, we do not anticipate a return to the record setting, high volume, serial acquisition activity that characterized much of the past 10 years.

Home Health Care. With more than 100 transactions completed in 2007, and 51 completed in the first 6 months of 2008, home health care has become the hottest merger and acquisition sector in the broad home care arena. Fueled, in part, by the steadily rising stock prices of the public players in the market and investments in the industry by private equity groups looking to capitalize on this wave of enthusiasm, the demand for acquisition candidates continues to rise, propping up transaction volume – and valuation. Even with changes in the prospective payment system – notably reductions in payments attributable to reimbursement "creep" of nearly 11% factored over the next four years – the market remains confident in the long-term prospects for the industry. As such, we anticipate a long period of consolidation activity – and opportunity – in home health care.

Continued on next page

Home Infusion Therapy. Although the home infusion therapy sector, with decidedly fewer providers, cannot match the volume of the home health sector, it is nevertheless, one of the most attractive M&A sectors today. While the underlying economics of infusion have not changed dramatically over the past few years, private equity – likely drawn to (a) expanded opportunities in pharmaceuticals courtesy of the Prescription Drug Bill and (b) the higher margins service oriented infusion providers can command – "discovered" the sector two years ago, fueling a buying spree that contributed to record setting transaction volume in 2007 (25 deals). We expect this trend to continue as these consolidators continue to build size (predominately through acquisitions) to secure a profitable exit via a sale or public offering.

The good news is that with the extraordinary imbalance of supply vs. demand, valuation remains quite attractive.

Hospice. For the hospice sector, from a merger and acquisition perspective, it's all about supply, or more accurately, the lack thereof. While acquisition demand remains nearly as strong as during the 2002-2004 period when hospice was in the spotlight of home care consolidation, the supply of acquisition candidates, particularly those that are (a) for-profit, and (b) not in danger of exceeding reimbursement cost caps is extremely limited. Accordingly, transaction volume in 2007 (10 deals) fell to its lowest point since 2001. The good news is that with the extraordinary imbalance of supply vs. demand, valuation remains quite attractive. Furthermore, we expect volume to begin to tick upward over the next 24 months as the M&A pipeline "re-loads" with companies that, having begun operations over the past two to three years – in part, to capture some of the returns seen during the market's peak – mature and get ready to test the market.

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