a look back 2005

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the braff group

2006 a look forward

Inside:

The Braff Group is a leading middle market merger and acquisition firm that specializes in the home medical equipment, home health care, hospice, staffing, specialty pharmacy, infusion therapy and eHealthcare market sectors. We provide merger and acquisition representation, strategic planning, and valuation services.

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Highlights

- Deal volume reaches a new record high with 247 transactions.
- The Home Health sector surges to a record 75 deals.
- The TBG Health Care Composite Index rises 10.7%. New all-time high reached in November.
- Valuations rise in Medicare, Medicaid, and Private Home Health, Infusion Therapy, and Health Care Staffing.

The Year in the Merger and Acquisition Activity

M&A transaction volume over the past three years has grown a robust 14.7%.

It was yet another record setting year for M&A activity in the broad home care and health care staffing arena. With 247 transactions announced and/or completed in 2005, volume was up 7.4% over 2004. More impressive, while individual sectors have ebbed and flowed, it was the 4th consecutive year that aggregate transaction volume has increased. In fact, over the past three years, we have seen a robust 14.9% compound annual growth in activity.

Key Observations:

From an M&A perspective, 2005 will be remembered as the year in which the home health sector fully emerged from a near 7 year period of lackluster performance.

- Without question, 2005 will be remembered as the year that the **Home Health Care** sector fully emerged from a near 7 year period of lackluster performance (following the Balanced Budget Act of 1997) . The turnaround began in earnest in 2004, when transaction volume surged 31%. The momentum continued in 2005 with growth of 27% and a new record of 75 deals. Moreover, the number of sizeable transactions (revenues and/or purchase prices of $10M or more) also increased. While in In 2004, we identified 7 transactions in this range (2 of which were greater than $50M), we saw 12 such transactions in 2005 (5 of which exceeded the $50M range). Finally, publicly traded firms that, with few exceptions, have stayed on the M&A sidelines, made their presence known in 2005, accounting for 58.7% of the transactions during the year compared to only 22.0% in 2004.

For the first time in five years, transaction volume in the home medical equipment sector declined.

- 2005 was a bellwether year for the **Home Medical Equipment** sector as well, but for an entirely different reason. While the 87 deals completed in 2005 was the second highest total recorded over the past five years, it is the first time during the period that transaction volume has declined — a 10.3% fall-off from the record 97 deals posted in 2004. Given two consecutive years of significant reimbursement pressure, such a slow-down was likely inevitable. After demonstrating extraordinary resilience after other major cuts in reimbursement over the past 20 years, in light of the December surprise capping oxygen reimbursement at 36 months (see Top 10 Events of the Year), it will be interesting to see how both buyers and sellers respond to this very new threat. Suffice to say, 2006 may be a pivotal year for the HME merger and acquisition market.

  One other item of note: With three major transactions during the year involving firms that specialize in diabetic supplies, wound care, urologicals, respiratory supplies, and other disposables (Warburg Pincus' acquisition of CCS Medical and MP TotalCare — two of the largest deals of the year — and Owens and Minor's acquisition of Access Diabetic Supply), we anticipate further activity in the HME supply niche.

The health care staffing sector continued to record strong M&A activity in 2005 with 38 deals.

- Proving the 80% surge in **Health Care Staffing** transaction volume that we observed in 2004 vs. 2003 was no fluke, the sector recorded a slight up-tick in activity (5.6%) in 2005 to post a new record of 38 transactions. Perhaps more revealing, after being unaccounted for in the Top 10 Deals of the Year in 2004 (the sector contributed 3 of the largest transactions in 2003), health care staffing accounted for two of the largest deals in 2005 — The Blackstone Group's acquisition of TeamHealth and AMN Healthcare's acquisition of The MHA Group — both of which were the largest transactions in the sector since 2002.

Increased interest from private equity groups and other investors bodes well for continued growth in infusion therapy transaction volume.

- The **Infusion Therapy** sector also continues to shine. While it accounts for a modest 6.5% of total transaction volume, activity surged 45.5% in 2005, setting a new record of 16 deals. Moreover, during the latter part of 2005, we began to field substantially more inquiries from private equity groups and other investors interested in gaining a foothold in the sector. Accordingly, we anticipate continued M&A growth in infusion therapy in 2006.

The Specialty Pharmacy sector rebounded nicely from 2004 with 19 deals.

- The **Specialty Pharmacy** Sector rebounded nicely from what may have been an anomaly in 2004, recording 19 transactions in 2005, up 58.3% over the prior year. Also noteworthy, two of the largest and most active buyers in the sector over the recent past were acquired themselves in 2005 — Medco Health Solutions' acquisition of Accredo Health, and Express Script's acquisition of Priority Healthcare.

- While in raw numbers, transaction volume in the **Hospice** sector declined modestly from 15 deals in 2004 to 12 in 2005, the nature of these transactions has changed dramatically.

While 4 of the deals in 2004 were sizeable, platform type transactions, there was only 1 deal of such type in 2005, and that transaction occurred in the first quarter. This reflects the facts that (a) the hospice sector has predictably moved from an initial phase of acquisition activity (that began in 2003) in which buyers (notably private equity groups) targeted large providers to gain a strong foothold in the industry, to a more "mature" phase in which the bulk of transactions are smaller, "layer-on" deals and (b) while additional opportunities to enter and develop a presence in the sector remain possible, many erstwhile hospice acquirers have turned their attention to the home health market.

The hospice market has entered a more mature phase of M&A activity in which the bulk of transactions are smaller, "layer-on" deals.

- For the fourth consecutive year, the size of the largest transactions in the sectors we cover rose. In 2005, the median size of the top 10 deals of the year surged 145% to a record $269.4 million.

The largest deals of the year continue to get larger

Merger & Acquisition Transaction Trends

Sector	Number of Deals 2004	% of Total	Number of Deals 2005	% of Total	Change
Home Health Agencies	59	25.7%	75	30.4%	27.1%
Hospice	15	6.5%	12	4.9%	-20.0%
Staffing	36	15.7%	38	15.4%	5.6%
Home Medical Equipment	97	42.2%	87	35.2%	-10.3%
Infusion Therapy	11	4.8%	16	6.5%	45.5%
Specialty Pharmacy	12	5.2%	19	7.7%	58.3%
Total Transactions	**230**	**100.0%**	**247**	**100.0%**	**7.4%**
Unduplicated Buyers	109		107		-1.8%
Transactions per Buyer	2.11		2.31		9.4%
% **P**ublic vs. **N**on-Public **Buyers**	**P** 31.2% / **N** 68.8%		**P** 45.8% / **N** 54.2%		**P** 46.8% / **N** –21.2%
% **P**ublic vs. **N**on Public **Deals**	**P** 57.0% / **N** 43.0%		**P** 69.6% / **N** 30.4%		**P** 22.3% / **N** –29.5%

Top 10 Deals 2004 (a)			Top 10 Deals 2005 (a)		
Seller	**Buyer**	**Price**	**Seller**	**Buyer**	**Price**
Home Care Supply	Praxair	245,000,000	Accredo Health	Medco Health Solutions	2,200,000,000
Tender Loving Care	Crescent Capital	198,500,000	Priority Healthcare	Express Scripts	1,300,000,000
Hemophilia Res.of America	Accredo	159,000,000	TeamHealth	The Blackstone Group	1,000,623,000
Critical Care Systems	Curative	150,000,000	CCS Medical	Warburg Pincus	360,000,000
Matria Rx & Lab	CCS Medical	130,000,000	MP TotalCare	Warburg Pincus	270,000,000
Chronimed	MIM Corporation	90,000,000	excellRx	Omnicare	268,750,000
Hospice USA	Beverly Enterprises	69,123,152	RxCrossroads, LLC	Omnicare	235,000,000
Medmark, Inc.	LLR Parts/Quaker Bio	28,000,000	MHA Group	AMN Healthcare	195,000,000
Home Health Care Res. Inc.	Accredo	26,800,000	Housecall Medical	Amedisys	106,400,000
Good Shepherd Hospice	LifePath Hospice	24,000,000	PSA Pharmacy Business	Accredo / Medco	72,000,000
Total Transactions		1,120,423,152			6,007,773,000
Median Deal Size		110,000,000			269,375,000

(a) Except as noted, includes only deals in which purchase prices have been made public. Excludes Braff Group transactions in which deal terms were not publicly announced

Top 10 Events of 2005

After absorbing substantial reimbursement cuts earlier in the year, the HME sector was unable to fight off further cuts announced in the 4th quarter.

1. **A Difficult Year for the Home Medical Equipment Sector.** Even after monumental reimbursement cuts in nebulizer medications as well as cuts in other HME equipment and supplies at the start of 2005, and legislation in place to initiate competitive bidding in 2007, the sector was unable to stave off an estimated 9% weighted average cut in oxygen in March and yet another hit to nebulizers via cuts in dispensing fees in November. Adding to the frustration of the industry, the HME and O2 cuts were driven off less-than-comparable Federal Employee Health Benefit Plans and the neb cuts may have been based, in part, on research by the OIG on nebulizer dispensing fees that, by all accounts, was exceedingly flawed. All this, and the Government wasn't done reducing reimbursement (see number 10).

The withdrawal of Tysabri shook the confidence of Specialty Pharmacy Services market.

2. **Tysabri is Pulled From the Market.** With both Synagis and IVIG margins under substantial margin pressure, the Specialty Pharmacy sector eagerly anticipated the introduction of Tysabri, a promising new drug for the treatment of MS. However during drug trials in which Tysabri was administered in combination with Avonex, two patients were diagnosed with a rare and serious disease of the central nervous system, one of which proved fatal. As such, it was immediately pulled from the market, dashing, at least temporarily, the hopes of patients and shaking the confidence of, and in, the specialty pharmacy industry. On the positive side, the drug remains in clinical trials and as recently as September 2005, the manufacturers filed with the FDA to conduct a priority review to reintroduce the drug.

The aftermath of Katrina will likely drive health care spending polices for years to come.

3. **Hurricane Rita Further Strains the Federal Budget**. In addition to the flood waters and devastation caused by Hurricane Katrina, the storm may also be remembered as the wild card that broke the Federal budget's back. With costs to bring the region back to a semblance of normality estimated at $200 to $300 billion dollars, the aftermath of Katrina will likely drive health care spending policies for years to come.

Absent reimbursement for the majority of pharmacy and nursing services, supplies or equipment, it may not be feasible for providers to safely — and profitably — administer IV drugs under Medicare Part D.

4. **Pharmacy Services Remain Largely Excluded from the Prescription Drug Bill.** When the prescription drug benefit was passed in 2003, the infusion therapy industry was cautiously optimistic. While the expansion of drug coverage was extremely promising, the benefit did not cover reimbursement for the majority of pharmacy and nursing services, supplies, or equipment necessary to safely – and profitably – administer these therapies. For nearly two years, the industry has fought hard to have the IV benefit patterned after those currently in-place in many Medicare Part C programs or to have the benefit shifted to part B, either of which would provide the basis to receive reimbursement for these requisite services. Alas, while CMS appears to have acknowledged the problem and a recent study conducted by Muse & Associates concludes that moving IV coverage under part B could "offer the potential for significant overall savings through reduced hospital admissions", the program began on January 1st, 2006 without any regulatory intervention. While the industry continues to press on, at this point, our sense is that both CMS and Congress, overstressed by a difficult and expensive program, will choose to sit back and see how things play out.

Values for large home health care providers rose exceptionally fast in 2005.

5. **Parthenon Captures a Fast Return on its Investment in Accumed.** In order to capture the kind of financial returns private equity groups crave, the typical investment horizon in a company is about 3 to 7 years. But in a surprising turn of events, Parthenon Capital successfully exited its investment in regional home health provider Accumed Home Health in only 13 months, a development emblematic of the exceptionally fast and meteoric rise in value of large Medicare home health agencies that occurred in 2005.

6. **A Medicaid Home Health Investment Strategy Emerges.** In 2000, when the whole home health world seemed to forgo any kind of aggressive acquisition strategy in order to turn its collective attention inward in order to implement the Medicare Prospective Payment System, Transition Capital Partners (TCP) took an entirely different path by acquiring Medicaid provider Texas Home Health. TCP theorized that the value of Medicare agencies was likely to soar in the future, and that the most cost effective, and operationally efficient platform upon which to enter the market and build a Medicare presence, could, in fact, be a large Medicaid provider. With a successful exit via sale to private equity group Friedman, Fleisher, and Lowe in the fall of 2005, we expect other investors to consider similar strategies.

An emerging strategy to enter a market and develop a Medicare home health presence is to start with the acquisition of a large Medicaid provider.

7. **Managed Care Positioned to Gain Penetration.** While Medicare Managed Care has long gained headlines, relatively few beneficiaries have embraced these plans. But that may change in 2006. First, in an effort to shift dollars from fee for service Medicare to Medicare Managed Care, the government has substantially increased payments to these plans, making them substantially more profitable – and worthy of aggressive marketing efforts to attract seniors. Second, Medicare/Medicaid dual eligibles are being thrust into these programs – like it or not. Finally, with offers to combine health care benefits with prescription drug coverage requiring little or no-copays, Medicare Advantage plans now have something extra to offer beneficiaries overwhelmed by the complexities of Medicare Part D. Should this occur, any significant migration of fee for service beneficiaries to managed care could impact operations, profit margins, and diversification strategies, all of which could have a profound affect on acquisition strategies.

The market conditions and financial incentives may be just right for Medicare Managed Care to attract more Medicare beneficiaries than it has in the past.

8. **Locum Tenens and Allied Staffing Targeted for Health Care Staffing Growth.** With *Staffing Industry Analysts* projecting 2006 growth rates for Locum Tenens (physician staffing) and Allied Staffing of 12% and 9.5% respectively, it was only a matter of time before buyers began to aggressively target these health care staffing niches. In October, AMN Healthcare Services announced that it would acquire physician and allied staffing provider, The MHA Group, for total consideration of $195M. Less than a week later, The Blackstone Group, a private equity firm, announced that it would invest $1 billion to capture Team Health, the nation's largest physician and allied staffing company. We anticipate that this strategy will gain further momentum over the coming year, to include firms on a smaller scale as well.

The Physician and Allied Health Care staffing niches are expected to grow 12% and 9.5% respectively in 2006.

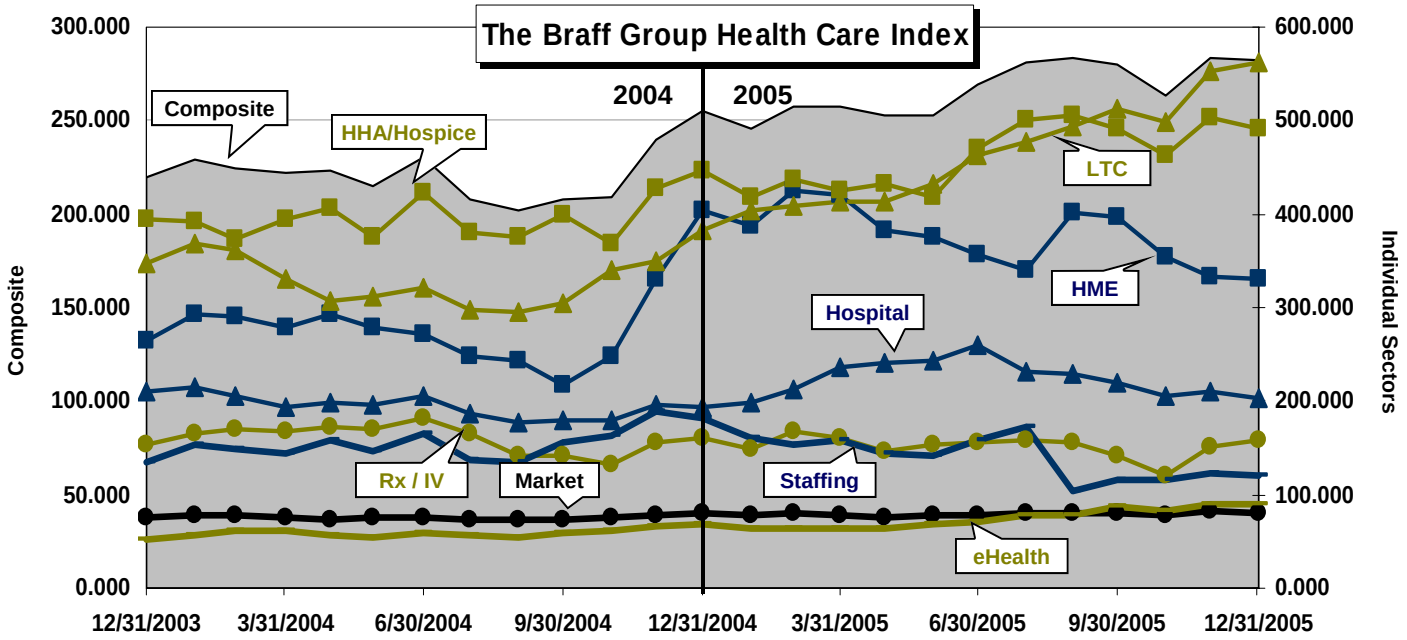
9. **LHC Group Completes the First Home Health IPO in 10 Years.** On June 14th, 2005, LHC Group of Louisiana completed the first initial public offering in the broad home care arena since 1995. Well received by the Street, this was a bellwether event for the home health industry as it drew substantial attention from both public and private investors — the kind of attention that stimulates demand, which, in turn, enhances valuation.

LHC Group's IPO was well received by the investment community.

10. **House and Senate Approve Versions of the Deficit Reduction Act.** Faced with an escalating budget crisis, at year end both halves of Congress approved versions of a deficit reduction bill that was officially passed on February 1st, 2006 . The act calls for rescinding the 2.8% home health PPS rate hike scheduled to go into effect January 1, 2006 (as well as a one year **reinstatement** of the rural add-on). Perhaps more damaging though was the initiation of a thirty six month cap on oxygen reimbursement. While this legislation will have no immediate financial impact on the respiratory sector – the 36 month clock starts on January 1, 2006 regardless of how long an existing patient has been on service – it has spiked the sector's risk by providing Congress with yet another mechanism to reduce reimbursement in the future.

A 36 month cap on oxygen reimbursement provides Congress with yet another mechanism to make further cuts in the future.

The Year in the Public Markets



	Market	HME	HHA / Hospice	Staffing	Rx/IV	Hospital	Long Term Care	eHealth	Composite
2004 End	80.5	404.2	446.9	182.0	160.6	194.5	382.5	69.2	254.6
2005 High	**81.9 / Nov.**	**425.6 / Feb.**	**505.8 / Aug.**	**171.3 / July**	**167.3 / Nov.**	**259.5 / June**	**563.2 / Dec.**	**90.4 / Nov.**	**283.6 / Nov.**
2005 Low	**75.4 / Apr.**	**330.4 / Dec.**	**418.3 / Jan.**	**103.5 / Aug.**	**121.0 / Feb.**	**198.7 / Jan.**	**404.5 / Jan.**	**63.1 / Jan.**	**245.7 / Jan.**
H-L Variance	8.6%	28.8%	20.9%	65.5%	38.3%	30.6%	39.3%	43.2%	15.4%
2005Close	81.4	330.4	491.5	119.7	158.4	204.2	563.2	90.0	281.8
2005Change	**1.0%**	**-18.3%**	**10.0%**	**-34.3%❶**	**-1.3%**	**5.0%**	**47.3%**	**30.0%**	**10.7%**

❶ On Assignment was added to the TBG Index in September 2005; therefore, the change in the *Staffing Index* does not fully reflect the 110.2% increase in On Assignment's stock price.

Aggregate Market Value of Invested Capital (in billions)

Quarter	HME	HHA	Hospice	Staffing	Rx/IV	Total
Q104	$ 6.6261	$ 0.7807	$ 1.0459	$ 1.6685	$ 0.7127	$ 10.8339
Q204	$ 6.7484	$ 0.8930	$ 0.9193	$ 1.5727	$ 0.7594	$ 10.8928
Q304	$ 6.2732	$ 0.8177	$ 0.8167	$ 1.3496	$ 0.8236	$ 10.0807
Q404	$ 7.9884	$ 0.9494	$ 0.6425	$ 1.5636	$ 0.8733	$ 12.0173
Q105	$ 8.1005	$ 0.8858	$ 0.6545	$ 1.4665	$ 0.9261	$ 12.0335
Q205	$ 7.8123	$ 1.0453	$ 0.7090	$ 1.3772	$ 0.9133	$ 11.8571
Q305	$ 7.7599	$ 1.1266	$ 0.7213	$ 1.4475	$ 0.9674	$ 12.0228
Q405	$ 7.2151	$ 1.1490	$ 0.7468	$ 1.5082	$ 0.9700	$ 11.5892
1 Yr Change	**-9.7%**	**21.0%**	**16.2%**	**-3.5%**	**11.1%**	**-3.6%**

Aggregate MVIC includes only firms that have been in the TBG Index for 8 consecutive quarters.

Top 10 Stock Performers of 2005

On Assignment	Staffing	110.2%
Capital Senior Living	LTC	82.7%
TriZetto Group	eHealth	78.8%
Cerner	eHealth	71.0%
Emeritus	LTC	62.4%
Odyssey	HHA	36.3%
Amedisys	HHA	30.4%
Beverly	LTC	27.5%
IDX Systems	eHealth	27.5%
HCA	Hospital	26.4%

The Braff Group Index measures the stock performance of 41 companies in seven key health care service sectors. The Composite includes all the companies in the index. All stocks were indexed to 100 on February 29, 2000. The Index is *un-weighted*. Accordingly, regardless of a firm's size and total market capitalization, the performance of each firm contributes equally to sector and composite performance. For a *weighted* measure of sector and composite performance, see Aggregate Market Value of Invested Capital. MVIC equals total shares outstanding x stock price less cash plus non-working capital interest bearing debt. Aggregate MVIC includes only firms that have been in the TBG Index for 8 consecutive quarters.

While the The Braff Group Broad Market Composite Index — comprised of the Dow Jones Industrial Average, the S&P 500, and the NASDAQ 100 — gained a mere 1.0% during the year, the TBG Health Care Composite Index surged 10.7% in 2005, closing out the year at 281.8, just below a new record high of 283.6 set in November. Moreover, illustrating the sustained performance of the health care service sectors we track, the Composite Index is in the midst of an extraordinary three year run-up. Since the index posted a 22% decline in 2002, it has gained 82%.

Over the past three years, the TBG Health Care Composite index has gained 82%.

Key Observations:

- After a remarkable rebound in 2004, the **Home Medical Equipment** sector closed down 18.3% in 2005. After a relatively strong 1st quarter start, the sector fell victim to (a) cuts in oxygen reimbursement tied to Federal Employee Health Benefit Plans, (b) soaring gas prices as a result of Hurricanes Katrina and Rita, and (c) cuts in nebulizer dispensing fees. Notably, however, was Wall Street's reaction to the 36 month oxygen cap, which, though signed into law in February 2006, was all but assured by year-end 2005. Since December 15th, 2005, through the end of trading February 2nd, 2006, the day after the Deficit Reduction Act was signed, the mean decline in the publicly traded HME firms was only 1.4%. So while the oxygen cap may have sent shock waves throughout the industry, the reaction from the Street was one of decidedly less concern.

While the 36 month oxygen cap may have sent shock waves throughout the industry, the reaction from Wall Street was one of decidedly less concern.

- 2005 was another strong year for the **Home Health and Hospice** sector which hit an all time high of 505.8 in August (the first sector to cross the 500 mark) before retreating slightly to close at 491.5 — up 10.0% for the year. Of particular note was the addition to the index of the LHC Group, which completed the first initial public offering in the home health segment in 10 years (see Top 10 Events of 2005). Compared to the HME sector, the public markets reacted a tad stronger to the impact of the Deficit Reduction Act, which eliminated the 2.8% update for Medicare services in 2006. Between December 15th and February 2nd, the day after the bill was signed, three publicly traded companies with significant Medicare services declined an average of 3.5% — still, a relatively modest reaction[1].

In August, the Home Health and Hospice sector became the first to cross the 500 mark.

- During a year in which expected cuts to reimbursement to **Long Term Care** providers were both delayed and largely offset by other increases in reimbursement, the market reacted swiftly and favorably, sending the Long Term Care index soaring 47.3% to close at a new all-time high of 563.2.

The Long Term Care sector index soared 47.3% in 2005.

- In order to reflect the merger between Chronimed and MIM Corporation (re-named Bio-Scrip) as well as the acquisitions of Priority Health Care and Accredo Healthcare, the **Specialty Pharmacy and Infusion Therapy** index has undergone substantial change during the year; accordingly, it is difficult to interpret the 1.3% fall-off in 2005. It is noteworthy however, that on a weighted basis, the sector's aggregate market value of invested capital increased 11.1%.

The SPS/IV sector's aggregate market value of invested capital increased 11.1% in 2005.

- Although the firms that currently comprise our **Health Care Staffing** index posted three consecutive quarters of mean revenue growth (with every firm's revenues rising in each of the last two quarters), the staffing index fell substantially. This was due, in part, to the meltdown of World Health Alternatives which fell 89.8% before we removed it from the index. We also note that while On Assignment surged 110.2% in 2005 and was the top stock performer of the year, it was added to the TBG Index in September of 2005, therefore the change in the Staffing Index does not fully reflect its performance. Alternatively, for another view of staffing industry returns, note that for those firms that have been in the index for 8 consecutive quarters, the aggregate market value of invested capital — a weighted measure of performance — declined only 3.5%.

The top performer of the year for all the stocks we cover was a staffing company — On Assignment.

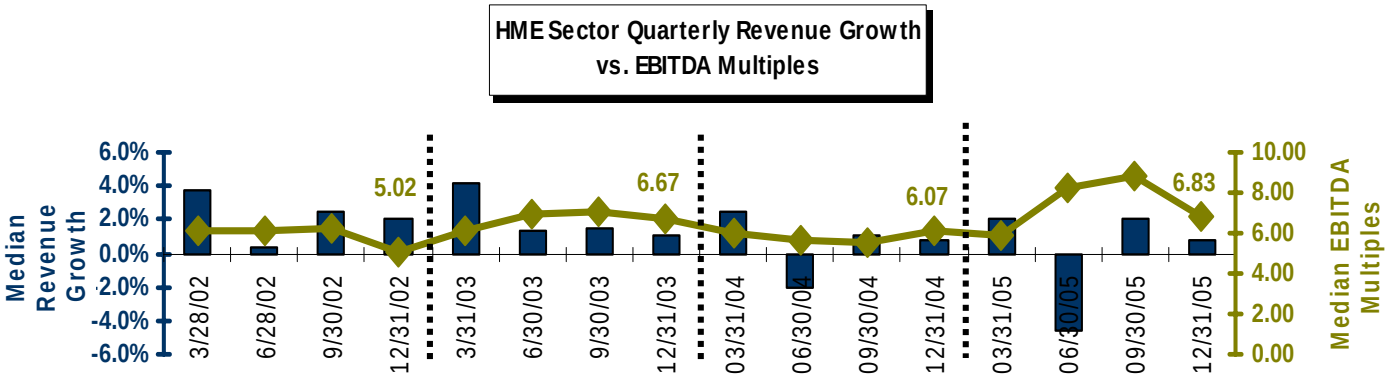
- As technology in general, and health care technology in particular, has once again captured the markets' attention, the **eHealth** Sector posted its second consecutive year of 30% annual growth. Moreover, three of the firms that comprise our index — Trizetto Group, Cerner, and IDX Systems — finished among our top 10 stock performers of the year.

For the second consecutive year, the eHealth care index posted 30% growth.

[1]For the purposes of this analysis, we excluded Gentiva as its early 2006 announcement of the pending acquisition of Healthfield may have clouded the impact of the Deficit Reduction Act.

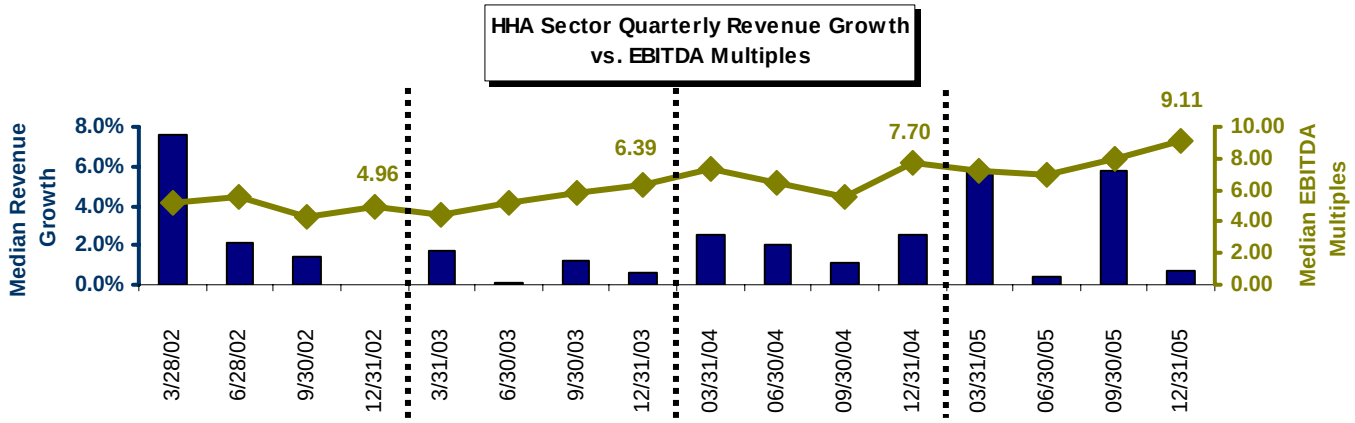
The Year in Public Company Performance and Valuation *

HME Sector	Shares Outstanding	Stock Price Dec-05	Market Cap	Less: Cash	Plus: Interest Bearing Debt	Total MVIC	Annualized Revenues	Annualized EBITDA	EBITDA Margin	MVIC/ Revs.	MVIC/ EBITDA
Lincare	97,237,996	41.91	4,075,244,412	(105,844,000)	447,607,000	4,417,007,412	1,253,972,000	444,553,333	35.5%	3.52	9.94
Apria	49,564,090	24.11	1,194,990,210	(12,440,000)	561,456,000	1,744,006,210	1,485,878,667	279,869,333	18.8%	1.17	6.23
Rotech	25,413,270	15.70	398,988,339	(37,293,000)	390,810,000	752,505,339	524,353,333	101,318,667	19.3%	1.44	7.43
American Home Patient	17,388,389	3.27	56,860,032	(7,616,000)	252,331,000	301,575,032	326,416,000	49,082,667	15.0%	0.92	6.14
Total Companies						7,215,093,993		Mean	22.2%	1.76	7.43
								Median	19.1%	1.30	6.83



Home Health Sector	Shares Outstanding	Stock Price Dec-05	Market Cap	Less: Cash	Plus Interest Bearing Debt	Total MVIC	Annualized Revenues	Annualized EBITDA	EBITDA Margin	MVIC/ Revs.	MVIC/ EBITDA
Amedysis	15,805,284	42.24	667,615,196	(20,750,000)	82,151,000	729,016,196	350,220,000	59,512,000	17.0%	2.08	12.25
LHC Group	16,591,870	17.43	289,196,294	(22,787,000)	11,102,000	277,511,294	156,348,000	26,620,000	17.0%	1.77	10.42
Gentiva	22,884,550	14.74	337,318,267	(94,384,000)	26,678,000	269,612,267	862,401,333	34,609,333	4.0%	0.31	7.79
Pediatric Services	7,267,238	14.10	102,468,056	(45,726,775)	20,585,697	77,326,978	172,182,610	4,577,780	2.7%	0.45	16.89
National Home Health Care	5,662,531	9.84	55,719,305	(17,110,000)	69,000	38,678,305	105,284,000	8,424,000	8.0%	0.37	4.59
Almost Family	2,326,690	16.00	37,227,040	(11,776,921)	8,940,526	34,390,645	74,991,421	5,043,476	6.7%	0.46	6.82
Total Companies						1,426,535,685		Mean	9.2%	0.91	9.79
								Median	7.4%	0.45	9.11

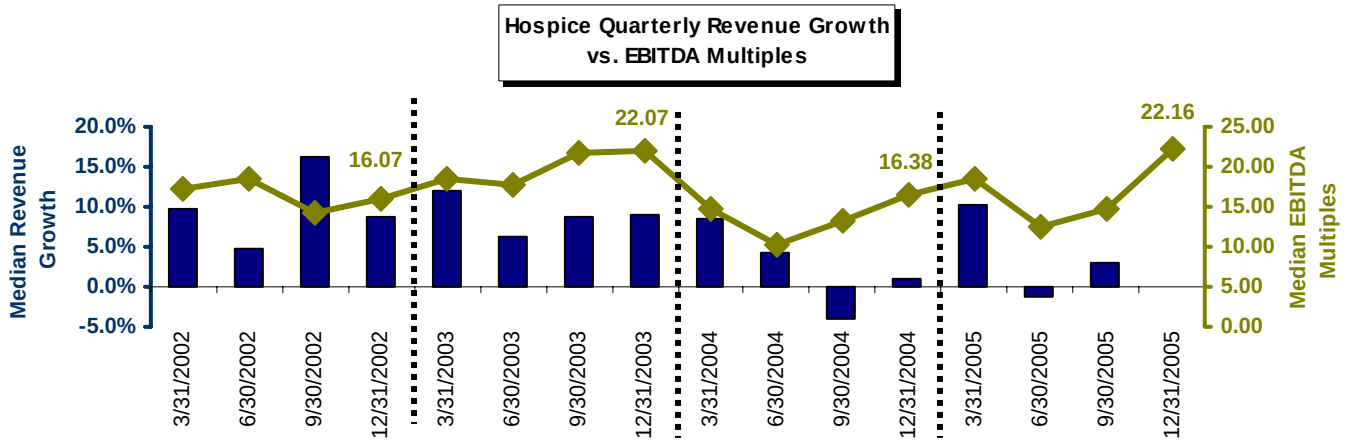
Notes: ❶ NHHC results are for 1Q06 (3 months ended 10/31/05) and PSAI for 4Q05- (year ended 9/30/05). ❷ Added LHC Group during 3Q05.



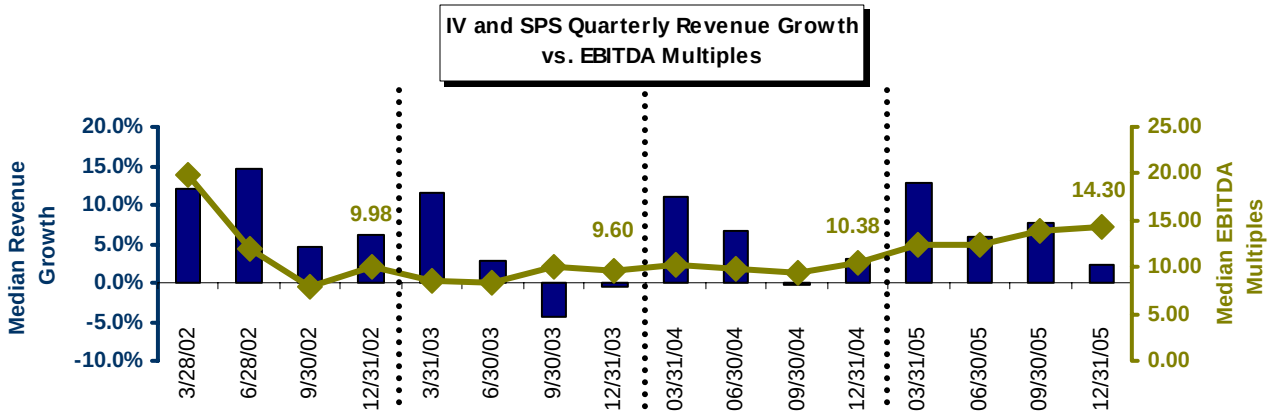
*Unless otherwise indicated, balance sheet and revenue/earnings data comes from 3Q05 filings. EBITDA includes adjustments for non-cash expenses, non-recurring items and other one-time events.

Hospice Sector	Shares Outstanding	Stock Price Dec-05	Market Cap	Less: Cash	Plus Interest Bearing Debt	Total MVIC	Annualized Revenues	Annualized EBITDA	EBITDA Margin	MVIC/ Revs.	MVIC/ EBITDA
Odyssey Healthcare	34,235,553	18.64	638,150,708	(56,374,000)	10,880,000	592,656,708	373,189,333	48,333,333	13.0%	1.59	12.26
VistaCare, Inc.	16,381,229	12.50	204,765,363	(53,375,000)	2,745,000	154,135,363	225,432,000	4,807,000	2.1%	0.68	32.06
Total Companies						746,792,070		Mean / Median	7.5%	1.14	22.16

Note: ❶ VistaCare results are for 4Q05 (year ended 9/30/05)



Infusion Therapy Sector	Shares Outstanding	Stock Price Dec-05	Market Cap	Less: Cash	Plus Interest Bearing Debt	Total MVIC	Annualized Revenues	Annualized EBITDA	EBITDA Margin	MVIC/ Revs.	MVIC/ EBITDA
Option Care	32,765,262	13.36	437,743,900	(63,751,000)	96,245,000	470,237,900	482,852,000	40,268,000	8.3%	0.97	11.68
BioScrip	37,087,645	7.54	279,640,843	-	3,795,000	283,435,843	1,025,321,333	17,858,667	1.7%	0.28	15.87
Curative	13,019,800	0.23	2,994,554	(249,000)	213,593,000	216,338,554	305,198,667	17,004,000	5.6%	0.71	12.72
Allion	12,801,998	11.65	149,143,277	(34,795,362)	1,611,567	115,959,482	113,681,920	3,882,611	3.4%	1.02	29.87
Total Companies						1,085,971,779		Mean	4.8%	0.74	17.53
								Median	4.5%	0.84	14.30

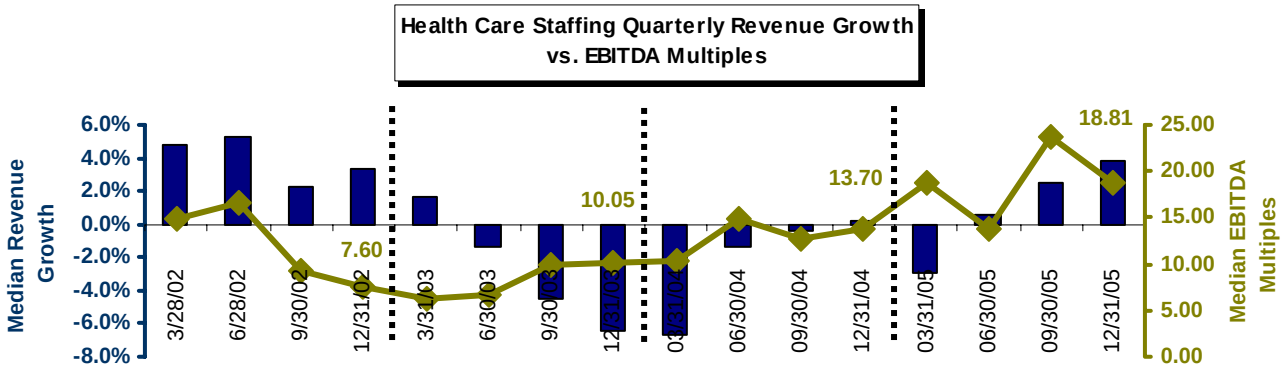


The Year in Public Company Performance and Valuation

continued

Health Care Staffing Sector	Shares Outstanding	Stock Price Dec-05	Market Cap	Less: Cash	Less Interest Bearing Debt	Total MVIC	Annualized Revenues	Annualized EBITDA	EBITDA Margin	MVIC/ Revs.	MVIC/ EBITDA
AMN Healthcare Svcs.	28,770,147	19.78	569,073,508	(14,739,000)	96,890,000	651,224,508	645,885,333	45,729,333	7.1%	1.01	14.24
Cross Country Staffing	32,163,686	17.83	573,478,521	-	61,983,000	635,461,521	639,476,000	33,789,333	5.3%	0.99	18.81
On Assignment	25,659,904	10.91	279,949,553	(25,303,000)	110,000	254,756,553	230,873,333	4,722,667	2.0%	1.10	53.94
Medical Staffing Net.	30,235,099	5.37	162,362,482	(254,000)	34,764,000	196,872,482	406,474,667	7,686,667	1.9%	0.48	25.61
ATC Healthcare	30,630,090	0.33	10,107,930	(697,000)	15,273,000	24,683,930	69,884,000	644,000	0.9%	0.35	38.33
Total Companies					Total	1,762,998,993		Mean	3.4%	0.79	19.55
								Median	2.0%	0.99	18.81

Notes: ❶ Results for ATC are for 2Q06 (6 months). ❷ Shaded items have been excluded from respective mean and median calculations.



The Year in Transaction Valuation

In discussing trends in valuation, it is critical to evaluate the complex interplay of external factors including Risk, Supply and Demand, and Market Intangibles – factors that (a) play a crucial role in acquisition and divestiture strategies, timing, and valuation and (b) are markedly different across the various home care sectors.

Risk Profile. Like any other investment alternative, acquisition opportunities are evaluated as a function of risk. The greater the risk, the greater the required rate of return, hence the lower the price an investor (or buyer) would be willing to pay for the investment, and vice versa. As we shall see below, just like individual companies have differing risk profiles, so do market sectors as a whole.

Supply and Demand. As we would expect in any other free market, merger and acquisition pricing is subject to the relationship between the collective supply and demand of sellers and buyers respectively. When demand exceeds supply, competitive market pressures drive pricing up.

Market Intangibles. While it is tempting to believe that M&A activity is ultimately math and finance driven, there are "soft", non-objective, emotional factors that enter the equations. These intangibles, often rooted in industry cultures and conventional wisdom, can have a profound impact on M&A activity and valuation.

The following is a review of where each sector stands with respect to each of these external factors, as well as their collective impact on valuation trends. The arrows illustrate how changes in these factors contribute to increases in value (upwards arrow), decreases in value (downwards arrow), or no change in value (sideways arrows). **For Risk Profile, an upwards arrow reflects a *positive* impact on valuation as a result of a *decrease* in the sector's risk profile.**

Medicare Certified Home Health

Risk Profile. As we reported in our 2003-2004 M&A Annual Report, the passage of the Medicare Modernization Act, with language providing for market basket updates less .08% from 2004 to 2006, placed the Medicare home health sector at the beginning of an extraordinarily favorable 3 year reimbursement window. Even with the recently passed Deficit Reduction Act that calls for the elimination of the 2006 update (as well as a one year **reinstatement** of the 5% rural add-on), Congress has clearly delivered on the promise of stability.

Over the past three years, even with the recently passed Deficit Reduction Act that calls for the elimination of the 2006 update (as well as a one year reinstatement of the 5% rural add-on), Congress has clearly delivered on the promise of home health reimbursement stability.

It stands to reason though, especially in light of (a) soaring budget deficits, (b) unanticipated hurricane related expenditures and (c) the specter of the price tag for the Prescription Drug component of the MMA finally hitting the books in 2006, that as we near the exit of this window of stability, the sector will be exposed to reimbursement risk from several fronts. We anticipate further rumblings from MedPac and other government players to reduce reimbursement *directly* through reductions in the base PPS rates and/or *indirectly* through the rebalancing of case mix weights/HHRGs which could reduce the profitability of the most "attractive" patient types (we note that this could be offset, in part, by increases in reimbursement for some of the less attractive, i.e. low margin or profit loss patients). We also anticipate discussion once again regarding co-pays. The difference this time around, though, is that the financial realities, i.e. budget shortfalls, are fast becoming as "real" and immediate as they can get. And finally, the industry faces potential erosion of revenues from an entirely different direction as expected increases in enrollment in Medicare Advantage plans (especially when these plans are coupled with reduced or no premium prescription drug coverage) threaten to reduce the number of traditional fee for service beneficiaries and, for participating providers, the revenues per visit and visits allowed per patient.

While we (a) do not expect that all (or perhaps any) of these initiatives will come to pass over the next 6 to 18 months, and (b) remain extremely bullish on the long term prospects for the

The Year in Transaction Valuation continued

sector, after a prolonged period of relative calm, the mere discussion of reimbursement threats on multiple fronts increases the sector's risk profile.

Supply and Demand. Since 2002, when PPS was already in place for 15 months and substantially better understood (and hence predictable), and further since 2003 when the MMA first opened the 3 year window of reimbursement stability (see Risk Profile above), the sector has been perfectly positioned for an extraordinary surge in acquisition demand. Alas, with some exceptions, the buying community was extremely slow to react. Many large players were unwilling to offer pricing that the risk-value fundamentals of the industry would suggest. Furthermore, again with some exceptions, too many private equity players were chasing too few hospice companies, distracting them from investing in what is certainly a larger and more fragmented industry (and arguably one that can generate even more attractive returns).

In 2005, Home health acquisition demand surged on every front — from the large publicly traded firms, to mid to large size privately held regional firms, to private equity groups which finally turned their collective attention from hospice to Medicare home health.

Though we saw some sparks of activity in 2004, the sector finally delivered on its promise in 2005. Acquisition demand surged on every front – from the large publicly traded firms (including newly public LHC Group), to mid to large size privately held regional firms, to private equity groups (PEGs) which finally turned their collective attention from hospice to Medicare home health. The size of the transactions also surged, with more acquisitions of firms with revenues of $20 to $50 million and up than we have seen in perhaps as many as 10 years. This, in turn, has sparked greater interest in smaller companies of between $5-10M in revenues as companies look to accelerate their growth and capture the valuation premiums currently being bestowed to the larger providers. Almost overnight, demand has gone from cautious and deliberate to exuberant and aggressive, perhaps reflecting a desire to catch up on 3 plus years of lost time and lost opportunity. And while an invigorated market has drawn more sellers to consider divestiture, the acceleration of demand has far out-paced the increase in supply.

As we enter 2006, the drag on home health M&A activity born of BBA 97 has been supplanted by momentum and optimism that should propel the industry toward another record setting year.

Intangibles. Given the sudden and enormous increase in acquisition demand and activity, the Medicare home health sector is in the midst of an acquisition frenzy quite similar to what we saw in hospice in 2003. As we enter 2006, the drag on the industry born of BBA 97 has been supplanted by momentum and optimism that should propel the industry toward another record setting year.

A Cautionary Note. We do note one cause for concern. Arguably, acquisition demand, activity, and valuations may have accelerated too far, too fast, leaving the industry vulnerable to a market "correction" wherein buyers "over-react" to any of the challenges suggested above (see Risk Profile) should one or more come to pass. This could send demand, activity, and valuations *below* where they "should be" just as rapidly as they rose. In time, equilibrium would be restored. But should this occur, market timing will be come increasingly critical for prospective sellers looking to catch "the wave".

Valuation Trends. Greater risk notwithstanding, increased acquisition demand and favorable intangibles have contributed to a surge in the valuations of Medicare certified home health providers. Notably, while not a valuation metric per se, the long accepted "cap" on valuations artificially set at below one times revenues has almost completely eroded, allowing pricing to rise to levels more commensurate with the sector's risk-return fundamentals. As suggested above however (see "A Cautionary Note"), such a favorable environment could be interrupted, at least temporarily, should the market "over-correct" for any anticipated threats that come into play.

The long accepted "cap" on home health valuations artificially set at below one times revenues has almost completely eroded.

Hospice

Risk Profile. While little happened from a reimbursement perspective to impact the sector's "real" risk profile, the perception of risk edged upwards again in 2005 following a difficult 2004 when the stock prices of several publicly traded providers plunged 50%. Similar to what we saw in 2004, the principle culprit this past year was continued difficulties in managing cost caps.

Monitoring and maintaining the delicate balance between typically higher profit margin, longer lengths of stay (LOS), non-cancer patients with lower margin, shorter LOS cancer patients to remain under cost limits remains a difficult and speculation-laden task. Some firms have even resorted to offering incentives to sales reps to identify and bring in shorter LOS patients when threatened with cap exposure. Firms are beginning to scrutinize the markets they are serving, the theory being that the most acute patients tend to cluster around urban markets with hospitals that generally have greater resources to treat the sickest patients, leaving rural markets with a disproportionate number of less acute, longer term patients.

Monitoring and maintaining the delicate balance between short and long length-of-stay patients to remain under cost limits remains a difficult and speculation laden task.

Interestingly, the solution to managing short and long length of stay patients profitably – without cap surprises – may lie in an initiative that many providers fear: moving from fixed daily rates that do not vary from patient to patient to those that vary based upon patient acuity. Such a home health PPS-like system could create more uniform margins across patients, lessening incentives that reward patient selection (and subject the firm to increased risk). Alas, with rebalancing initiatives for home health PPS likely to be a greater priority, such a change is not likely to occur over the short term.

Supply and Demand. In 2005, the nature of acquisition activity shifted meaningfully from that which we had seen in 2003 and 2004. While in the earlier stages of hospice consolidation there was a greater emphasis on entry-point, platform sized transactions, the market has matured to one focused largely on smaller, "layer-on" transaction deals. Furthermore, while additional opportunities to enter and develop a presence in the sector remain possible, many erstwhile hospice acquirers have turned their attention to the home health market. Accordingly, while interest in smaller hospice providers is somewhat greater than last year, demand for the larger platform sized firms, while still present, has, in fact, lessened.

Compared to 2003 and 2004, the hospice M&A market has matured to one focused largely on smaller, "layer-on" transactions.

Intangibles. With the hospice M&A market moving into a more "mature" phase and the home health sector re-capturing the spotlight it enjoyed during the early 90's, the fervor characterizing the sector has finally, and inevitably, settled.

Valuation Trends. As merger and acquisition strategies have transitioned from initial *entry* to *development*, valuation models have changed from being driven primarily by measures of *capacity* (average daily census) to those driven by *profitability* (EBITDA). As a result, the willingness to pay premium value to enter a market, regardless of a provider's profitability, has declined. Furthermore, as buyers evaluate "go-forward" EBITDA, they have become far more cautious with respect to cap exposure, often setting aside additional reserves (thereby lowering profitability) for many of the most profitable firms (often those with the longest lengths of stay). Taken together, and combined with declines in demand (for larger firms) and overall market enthusiasm, for the first time in a long time, valuation in this sector has declined.

Hospice valuation models have changed from being driven primarily by measures of *capacity* to those driven by *profitability*.

Medicaid and State Funded Home Health

Risk Profile. With consumer directed care initiatives that threaten to capture patients from full service agencies showing no signs of abatement and a Deficit Reduction Act calling for $4-5 billion in *net* cuts to Medicaid spending over the next five years (on top of the $10 billion in reductions over five years beginning in 2007 that Congress passed this past April), it might appear that the past year (as well as the near term outlook) for Medicaid and state funded home care programs has been (and remains) grim. Yet, while the program certainly faces substantial challenges as we head into 2006, there have been considerable positive signs for Medicaid in general and home care in particular.

While the Medicaid program certainly faces substantial challenges as we head into 2006, there have been considerable positive signs for Medicaid in general and home care in particular.

To begin with, for some perspective, note that while the $15 billion in cuts passed over the past 12 months are certainly unwelcome, they represent less than three quarters of one percent of the more than $2 trillion in Medicaid spending predicted over that period in the 2005 National Health Expenditures Report. Next, according to several recent reports issued by the Kaiser Commission on Medicaid and the Uninsured, as predicted, for the second consecutive year state tax revenues have increased – 4.9% in Fiscal Year 2005 compared to an increase of 3.2% in Fis-

The Year in Transaction Valuation continued

In October of 2005, the Kaiser Foundation reported that "after several years of extreme fiscal stress, state budgetary pressures are easing as the gap between Medicaid spending growth and state tax revenue growth declined to 2.6 percent, its lowest level since 1999".

cal 2004. At the same time, due to a combination of cost containment strategies and a decline in enrollment growth due, in part, to improvements in the economy, the rate of Medicaid spending growth declined for the third consecutive year to 7.5% in FY 2005, down from a peak of 12.7% in 2002. As a result of these developments, in a press release issued in October of this year, Kaiser reported that "after several years of extreme fiscal stress, state budgetary pressures are easing as the gap between Medicaid spending growth and state tax revenue growth declined to 2.6 percent, its lowest level since 1999". Moreover, the foundation reports that "In FY 2005 and FY 2006 states also implemented more positive policy initiatives such as expansions and provider rate increases than in previous years". Notably, "in FY 2006, 25 states plan to implement some type of long-term care expansion, mostly related to *expansions in home and community-based care* [emphasis added] in an attempt to meet the growing demand for these services as Medicaid remains the dominant provider of these services".

While certain states remain in crisis, given all of the above combined with increased recognition that rebalancing initiatives designed to shift Medicaid spending from institutional settings to community based care can contribute mightily to further restraining growth in program spending, the risk profile for the Medicaid and state funded home health sector, on balance, has definitely improved.⬆

Supply and Demand. While the risk profile for the sector has become more favorable, acquisition demand across a broad swath of the industry remains tepid. The lone exception is an increase in demand for the largest Medicaid providers – those with revenues in the plus/minus $50 million range – as a limited, but growing, number of private equity groups pursue an innovative acquisition and development strategy in which they target large Medicaid providers to obtain platforms upon which Medicare and other private pay services are layered on later. The basis of the strategy is an understanding that compared to Medicare providers (a) those that focus on Medicaid are generally more experienced in working under extremely tight margins, (b) that given the challenge of extraordinary turnover in non-skilled home health aides, they are likewise more experienced and skilled at recruitment and retention, and (c) given that they are not currently in the merger and acquisition spotlight – Medicaid focused firms do not currently command Medicare-like valuation premiums. As such, as the foundation of an entry and development strategy, large Medicaid providers can prove to be "high value" acquisition targets. Such was the strategy initiated by Transition Capital Partners (TCP) in 2000 when they acquired Medicaid provider Texas Home Health Care and subsequently added Medicare services over the ensuing five years. The plan culminated in October of this year when TCP sold the firm to private equity group Friedman, Fleisher, and Lowe.

Compared to Medicare providers, those that focus on Medicaid are generally more experience in working under extremely tight margins.

Non-platform providers: ⬌ Platform Providers:⬆

Intangibles. While the sentiment regarding the sector clearly remains guarded, the Texas Home Health transaction has clearly gained attention. And as (a) pricing for Medicare agencies continue to soar and with (b) private pay firms, with some exceptions, typically lacking the size and infrastructure necessary to support an expansion plan, the Medicaid arena, which previously has barely registered in the minds of buyers, is becoming an evermore viable option to support a development initiative.⬆

Medicaid agencies are increasingly being viewed as viable options to support a development initiative.

Valuation Trends. Except in those states with the most problematic, i.e. low, reimbursement, valuation is definitely up across the board, with the largest providers – those in the plus or minus $50 million range – enjoying the greatest surge.⬆

Large Medicaid providers are enjoying the greatest surge in valuation.

Private Pay Home Health

Risk Profile. Unlike most of the other home care sectors we cover, by definition, private pay home health care is not reliant on government funding which remains under tremendous strain. Accordingly, absent a substantial downturn in broad economic conditions that impact private spending on health care and health insurance, private pay remains substantially insulated from

the risk factors that plague the other sectors. In fact, health care policy initiatives designed to address budgetary constraints bode well for health care providers that serve the private sector.

Consider the government's push to shift spending from Medicare fee for service to Medicare managed care. With their experience in marketing towards, developing programs for, contracting with, and billing and collecting monies from private pay sources such as insurance companies and managed care organizations, many private pay providers are arguably better positioned than their Medicare focused colleagues to serve what could become a burgeoning pool of beneficiaries. Or consider the January 2005 report issued by the National Council on Aging, with funding from the Robert Wood Johnson Foundation ***and CMS*** entitled "Use Your Home to Stay at Home. Expanding the Use of Reverse Mortgages for Long Term Care: A Blueprint for Action", a primer on how to tap an estimated $2 trillion in home equity to fund long term care, including home care. And finally, consider the fact that with baby boomers increasingly facing the challenge of caring for their aging parents as well as their children, this so called "sandwich generation" is increasingly turning to long term care insurance policies to insure that their residential and, preferably, home care needs can be met in the future, without becoming a burden to their kids. With a growing acceptance that we cannot rely on government funding to pay for our health care needs, the private pay arena would appear poised for an exponential run-up in growth.⬆

Many private pay providers are arguably better positioned than their Medicare focused colleagues to serve the managed care market.

Supply and Demand. Given that the average private pay provider tends to be relatively small – less than $2 million in annual revenues – we have long pointed out that the sector is not a particularly good one to execute a classic consolidation strategy. A buyer would simply have to identify, negotiate, close, and integrate too many small firms to create any meaningful size. Alternatively however, we have definitely seen an increase in acquisition demand for private pay firms from providers that focus in other arenas – particularly Medicare home health and long term care — as a means to diversify their payer and service mix, as well as acquire the knowledge and expertise to serve this unique niche and capitalize on the opportunities suggested above. We expect this trend to develop further in 2006.⬆

Buyers are increasingly targeting private pay firms as a means to diversify their payer and service mix, to gain the knowledge necessary to serve this unique niche.

Intangibles. Amidst many of the developments discussed above, 2005 appears to have been a pivotal year for private pay. While decidedly short of the enthusiasm shown Medicare home health, private pay has evolved from an afterthought to one worthy of serious strategic and investment consideration. It remains to be seen whether such consideration translates to a wave of acquisition activity over the near term.⬆

2005 appears to have been a pivotal year for private pay.

Valuation Trends. With all of the arrows pointing upwards, it is no surprise that the valuations of private pay home care providers have likewise gone up in 2005 – and should continue to tick upwards in 2006. In particular, those providers with better than average size and with an operating and sales infrastructure capable of sustaining revenue streams and new referrals post-transaction, will capture the most attractive valuation multiples.⬆

Valuation of private pay providers should continue to tick upwards in 2006.

Home Medical Equipment

Risk Profile. 2005 was an extremely difficult year for the Home Medical Equipment sector. In the first few months of the year, based on comparison to Federal Health Employee Benefit Plans, the industry absorbed cuts in equipment, supplies, and oxygen. Furthermore, even after (a) reimbursement for nebulizer medications was slashed on January 1st as payment methodologies shifted from a discount off of Average Wholesale Price to Average Sales Price plus 6%, and (b) CMS sought information from the industry and concluded that dispensing fees were necessary and determined appropriate amounts to be paid in 2005, the agency later announced cuts for 2006 of 47.4% and 17.5% for a 30 day supply (following the first month) and a ninety day supply respectively. Finally, on February 1st, 2006, Congress passed the Deficit Reduction Act that included language providing for a 36 month cap on oxygen rentals. While the cut in oxygen and nebulizer dispensing fees are troubling, it is the 36 month cap which causes even greater concern because it provides Congress with a new mechanism for to make further cuts in the future (that said, Wall Street appears less concerned; from the time prior to the House and

From the time prior to the House and Senate passing their versions of the Deficit Reduction Act to the day after the Bill was officially passed on February 1st, 2006, the average stock prices of the publicly traded HME providers declined only 1.4%.

The Year in Transaction Valuation continued

Senate passing their versions of the Deficit Reduction Act to the day after the Bill was officially passed on February 1st, 2006, the average stock prices of the publicly traded HME providers declined only 1.4%).

Supply and Demand. Over the recent past, perhaps the most critical factor that has helped to sustain – and even spike – the values of home medical equipment companies in an extremely risky environment has been the imbalance of supply and demand. While many of the names have changed over time, the sector has been in a sustained period in which the number of aggressive buyers has exceeded the supply of attractive acquisition candidates. But we sense that this favorable imbalance may be shifting. In previous years when there have been reductions in reimbursement, many observers predicted waves of sellers hitting the market. However, as we have repeatedly predicted, "healthy" sellers would not, and did not, flood the market. The reason? Immediately after a reimbursement cut, rather than flee the market and consider a price that would likely be lower than what they could have received immediately prior to the cut, the most attractive sellers dig in and refocus their efforts on reengineering their businesses in order to recapture lost revenues, profits, and value. However, this time, we sense that the 36 month oxygen cap may, in fact, drive more non-fringe, i.e. quality providers, to the market, changing the supply and demand dynamics to one that may begin to favor buyers. The big difference this time around is that unlike other past changes in reimbursement, the 36 month O2 cap has no immediate financial impact that a prospective seller has to recover from in order to capture a valuation comparatively consistent with the recent past. Accordingly, while risk has gone up – creating motivation to consider a sale – revenues and earnings remain unchanged…for now. As such, we anticipate that an increasing number of acquisition candidates will consider advancing their selling time horizon.

We anticipate that an increasing number of HME acquisition candidates will consider advancing their selling time horizon.

Intangibles. In a sector that has persevered through nearly 20 years of repeated cuts in reimbursement – from oxygen guidelines to rent-purchase, to OBRA 90, to the Six Point Plan, to BBA 97, to the Medicare Modernization Act with its FEHBP and neb med cuts as well as competitive bidding – the HME industry has long been characterized by a "can-do" spirit and a culture of optimism. But for the first time, given the depth of, and short interval between, the cuts discussed above, we sense that industry may be succumbing to some fatigue. While we expect the collective psyche of the sector to rebound, even a temporary lull is notable.

Given the depth of, and short interval between, multiple reimbursement cuts, we sense that the industry may be succumbing to some fatigue.

Valuation Trends. Three downward arrows not withstanding, in a sector in which valuations have held strong, and even increased, during and after the repeated reductions in reimbursement referred to above, it is difficult to predict how the market will play out in 2006. That said, for the broad market sector, we anticipate a downward tick in valuation over the coming year. However, we sense that the most sizeable and attractive acquisition candidates may attract enough competitive interest to buck these M&A dynamics.

In a sector in which valuations have held strong, and even increased, during and after repeated cuts in reimbursement, it is difficult to predict how the market will play out in 2006.

Home Infusion Therapy

Risk Profile. For this section, we focus primarily on the prescription drug benefit and its potential impact on the home IV market. As we entered 2005, the big unknown shadowing the home infusion therapy market was how the prescription drug benefit would impact the industry. At that time, Lorrie Kline Kaplan, Executive Director of the National Home Infusion Association (NHIA) suggested that, "the new Medicare prescription drug benefit inspires both excitement and fear – mostly the latter. The details are too sketchy to predict whether the benefit will work". On the upside, beneficiaries would be covered for infusion therapy drugs that are not currently covered under part B, substantially increasing the sector's potential patient base. But there was a huge downside. Other than reimbursement for narrowly defined dispensing fees, characterized by CMS as ""reasonable pharmacy costs associated with ensuring that possession of the appropriate covered Part D drug is transferred to a Part D enrollee", the benefit would not cover the majority of pharmacy and nursing services, supplies, or equipment necessary to safely administer these therapies. Unless providers had the clout to negotiate extremely favor-

As we entered 2005, the big unknown was how the prescription drug benefit would impact the home infusion therapy industry.

able pricing from individual Part D plans, or unless they had the purchasing power to acquire covered drugs at extremely favorable rates, many observers feared that there would not be enough margin, or no margin at all, to provide these drugs and the required services profitably.

So as the year began, the potential benefits of the Part D program for infusion therapy providers depended on whether or not the industry was successful in obtaining additional service fees to compliment drug reimbursement and dispensing, either by having the benefit patterned after those currently in-place in many Medicare Part C programs or to have the benefit shifted to part B, either of which would provide the basis to receive reimbursement for these requisite services. Alas, even though (a) according to Kaplan, CMS has acknowledged that "the services, supplies and equipment integral to the provision of infusion drugs are medically necessary" and (b) a study conducted by Muse & associates concludes that "consolidating coverage for home infusion therapies under Medicare Part B beginning January 1, 2006 would result in a **maximum** (emphasis added) net cost to Medicare of approximately $182 million in federal fiscal year 2006, **but offers the potential for significant overall savings through reduced hospital admissions** (emphasis added), no action was taken to modify the benefit prior to its implementation on January 1st, 2006. With the reality that the benefit in its current incarnation will likely force patients into more expensive hospital and physician based settings to receive infusion therapies that could otherwise be delivered at home, with continued education from the industry, some observers remain optimistic that an appropriate mechanism will be found to cover requisite services and enhance the programs viability. Until then, an industry boosting opportunity remains just out of reach.

Other than reimbursement for narrowly defined dispensing fees, the Part D benefit will not cover the majority of pharmacy and nursing services, supplies, or equipment necessary to safely administer home infusion therapies.

With respect to the above, from a risk perspective, while the loss of an opportunity does not increase risk per se, we observe that if patients currently being served by home IV firms under non-Medicare funded programs migrate to Part D, providers may be subject to revenue erosion.

Leaving Part D, another issue worth noting: with Medicare adopting MMA mandated Average Sales Price plus 6% pricing for certain therapies, a rate schedule that significantly disadvantages "classes of trade" – notably small to midsize pharmacies – whose drug acquisition costs are traditionally substantially greater than that for hospitals and physicians, industry watchers are concerned that other payers such as private insurance, Medicaid, and managed care may follow suit, leading to increased margin pressure. ⬇

Supply and Demand. With an increasing number of exciting, complex, therapies in development that require greater clinical intervention and are therefore best suited to be distributed and administered by home infusion therapy providers (creating a conceptually new product category referred to as specialty infusion), the sector is poised for substantial growth. As such, we have seen a substantial increase in acquisition demand, particularly from private equity groups looking to gain a foothold in the market. This, in turn, has quite naturally spiked an increase in the number of attractive acquisition candidates considering divestiture strategies. For now, demand, particularly for large providers with revenues in the plus or minus $20 million range, far exceeds supply, creating an imbalance that currently favors sellers.⬆

With an increasing number therapies in development that require greater clinical intervention and are therefore best suited to be handled by home IV providers, the sector is poised for substantial growth.

Intangibles. As the demand for attractive acquisition candidates has increased, and the number of transactions completed have increased (up 45% over 2004), the sector is beginning to develop the type of vibrancy, enthusiasm, and momentum, that should fuel even greater M&A activity in the coming year. While the market has not returned to the peak levels seen during the early 90's, for the first time in a long time, a return to such heights no longer seems unachievable – a perspective on the industry that was virtually unthinkable a mere three years ago. ⬆

The IV sector is developing the kind of vibrancy, enthusiasm, and momentum that should fuel even greater M&A activity in the coming year.

Valuation Trends. Disappointment in the prescription drug bill notwithstanding, valuation in the home IV sector is nevertheless up.⬆

The Year in Transaction Valuation continued

Specialty Pharmacy Services

The continued challenge for the Specialty Pharmacy Services sector remains margin pressure.

Risk Profile. The continued challenge for the specialty pharmacy services sector (SPS) remains margin pressure. For example, over the past two years margins for Synagis have become exceedingly thin. For those drugs currently covered under Medicare Part B with reimbursement set at Average Sales Price plus 6% – notably IVIG – it's more of the same. On a positive note however, after vigorous lobbying by, among others, the Immune Deficiency Foundation, CMS announced that in 2006, it would establish a new add-on billing code with a payment rate of $69.00 to cover pre-administration related services for IVIG administered in a physician office setting. Similar to what we observed in the home IV market, margin pressure may also come from the fact that as the ASP+6 price schedule becomes further entrenched in the Medicare system, non-Medicare payers may begin to adopt similar pricing. With respect to the potential to serve an expanded patient base for drugs covered under Medicare Part B, absent reimbursement for requisite ancillary services, depending on the pricing negotiated with Plan providers and/or a pharmacy's drug acquisition cost, there may not be enough margin to take advantage of Part D profitably (for more details on Part D, see , The Year in Valuation, Home Infusion Therapy, Risk Profile).

The good news here? The sector is used to margin pressure. Moreover, with specialty therapies predictably having a limited window to produce high margins, it comes as no surprise that an effective margin protection strategy is to continually identify and develop new therapy programs to compliment existing products and services (which is one of the reasons the recall of Tysabri was so devastating to the industry — see Top 10 Events of the Year).

Although several of the most active acquirers have merged with other firms themselves, several relative newcomers have stepped in sustain acquisition demand.

Supply and Demand. With the mergers of historically aggressive buyers – Accredo Health and Priority Healthcare – with pharmacy benefit management firms Medco and Express Scripts respectively, it would be natural to anticipate an aggregate decline in acquisition demand. However this has not been the case as several relative newcomers have stepped in to pick up the slack. And in a market where the number of acquisition candidates, has been, and remains relatively limited, supply dynamics are unchanged as well. So as we enter 2006, supply and demand appears relatively in balance – and stable.

The SPS industry has entered a period of comparatively predictable risk and steady supply and demand, factors that should sustain M&A activity at historical levels.

Intangibles. While the Tysabri recall rocked the industry, the huge acquisitions of Accredo and Priority certainly sent positive market signals. Our read of the market is that while the unbridled enthusiasm for the sector peaked in 2003 and fell off somewhat in 2004, as our comments suggest above, the industry has entered a period of comparatively predictable risk and steady supply and demand, factors that should sustain M&A activity at historical levels – at least until the next mega-therapy is released (perhaps Tysabri), reimbursement is changed (perhaps adding a service component to Part D), or a new consolidation strategy emerges (reminiscent of the PBM/SPS model that gained favor in 2003), any of which could alter the interaction of factors that drive M&A activity.

Valuation Trend. Not surprisingly, given the above, valuation is holding steady.

Health Care Staffing

Four states introduced mandatory nurse staffing ratio bills in 2005.

Risk Profile. While no single event in health care staffing has likely had a substantial impact on the sector's risk profile, several developments, in combination, have improved the industry's prospects. For one, in November, Governor Schwarzenegger dropped his legal fight against mandatory nurse staffing ratios in California, which, since its initial enactment in January of 2004, has generated increased utilization of health care staffing. While California is the only state in the country thus far to pass such legislation, according to a State Legislation Tracker maintained by the Health Information Management and Systems Society (HIMSS), four states – Iowa, Massachusetts, New York, and Oregon – introduced nurse staffing ratio bills in 2005. Furthermore,

on the Federal level, both houses of Congress introduced nurse staffing bills during the year. While there remains substantial opposition to these mandates – and several initiatives in other states were defeated or put on hold during the year – support for minimum nurse staffing ratios appears to be gaining momentum.

Interestingly, in the January/February 2006 issue of Health Affairs, yet another study was released that demonstrated the impact of nurse staffing on outcomes and expenses. In an article entitled, "Nurse Staffing in Hospitals: Is There a Business Case for Quality", researchers concluded that by simply increasing the proportion of nursing hours provided by registered nurses, nearly 5,000 deaths per year could be avoided with net annual savings, assuming some recovery of fixed costs, of more than $1.8 billion. Moreover, the study found that by raising both the proportion of RNs and the total number of nursing care hours, more than 6,700 deaths could be avoided, at a net cost, again, assuming some recovery of fixed costs, of approximately $1.6 billion, or about 4 tenths of 1 % of annual hospital expenditures.

In a recent study, researchers concluded that by simply increasing the proportion of nursing hours provided by registered nurses, nearly 5,000 deaths per year could be avoided with net annual savings, assuming some recovery of fixed costs, of more than $1.8 billion.

Finally, we note that according to the American Association of Colleges of Nursing, enrollment in nursing schools rose for the fifth consecutive year. While more nurses could reduce the demand for health care staffing somewhat, the supply/demand gap remains huge. Accordingly, given the work flexibility that staffing provides and the travel opportunities that longer term, travel nursing offers, staffing firms, whose growth is typically limited more by a lack of professionals than assignments to fill, will be able to capture and deploy their share of revenue producing graduates.

Supply and Demand. With locum tenens and allied staffing projected to post the greatest growth among health care staffing services in 2006 – 12% and 9.5% respectively according to *Staffing Industry Analysts* – buyers are clearly beginning to target these segments. And with the number of specialists in these areas comparatively small, the balance of supply and demand currently favors sellers. As for core per diem and travel nursing, although 2004 and 2005 was characterized by emerging, mid-size firms targeting "opportunistic" acquisition candidates, with the industry beginning to deliver on the promise of turning the corner and the start of some positive momentum (see intangibles below), we may see more aggressive activity in these segments from a broader array of buyers in the coming year. Finally, we are increasingly seeing companies look to diversify their staffing services to include a mix of per diem, travel, locum tenens, allied, permanent placement, international nursing, and in some cases, home care. As such, acquisition demand for any of these segments, or niches within these segments, is now more likely to come from multiple fronts, rather than solely from firms with like services.

The Locum Tenens and Allied Staffing niches are projected to grow 12% and 9.5% respectively in 2006.

Intangibles. We clearly sense an increase in optimism in the health care staffing sector. The billion dollar acquisition of Team Health by The Blackstone Group, a well respected private equity firm, is the type of high profile transaction that draws the kind of Wall Street attention that can sometimes feed on itself. Furthermore, while the publicly traded firms have long been promising a return to revenue growth, for the first time since the end of 2002, the companies that comprise the TBG Health Care Staffing index posted three consecutive quarters of median growth (Q2 through Q4). Moreover, the growth rates accelerated during the period (see The Year in Public Company Performance and Valuation). Add to the mix predictions of industry expansion in 2006, the prospects for the sector are clearly the brightest that they have been since mid-2003.

For the first time since the end of 2002, the companies that comprise the TBG Health Care Staffing index posted three consecutive quarters of median growth.

Valuation Trends. Valuation is definitely trending upwards, especially for the locum tenens and allied staffing segments. That said, with respect to core per diem and travel staffing, after an extremely difficult two year period, the complete extent of the potential increase in valuation will not be fully realized until the market recovery is both fully realized *and* recognized.

2005 – Another Exciting Year for The Braff Group.

Last year, the *M&A Advisor* — a leading publication dedicated to middle market merger and acquisition activity — honored The Braff Group with its Healthcare Deal of the Year award…***for the second year in a row.*** In addition to having two transactions named as finalists for this top award, the firm was named as a finalist for Investment Banking Firm of the Year.

In addition, *The Pittsburgh Business Times* recognized the firm as the fourth-fastest-growing health care company in the Pittsburgh Region. This marks the second consecutive year The Braff Group was named to the Business Times Top 100.

PITTSBURGH BUSINESSTIMES

SUMMIT RESPIRATORY SERVICES **February 2005** the braff group represented the firm	D&T MEDICAL, INC. **March 2005** the braff group represented the firm	GEN CARE MEDICAL PRODUCTS **March 2005** the braff group represented the firm	orion The Brightest in Home Health Care **March 2005** the braff group represented the firm	optioncare of Indianapolis **April 2005** the braff group represented the firm
GEM GEORGIA EXTENDED MEDICAL **May 2005** the braff group represented the firm	Garrity HOME Care oxygen, medical equipment and supplies **May 2005** the braff group represented the firm	BANNER MEDICAL EQUIPMENT INC. **June 2005** the braff group represented the firm	Homestead Unlimited **June 2005** the braff group represented the firm	VitalAire **July 2005** the braff group represented the firm
Performance Home Medical Equipment, Inc. **July 2005** the braff group represented the firm	OPTIMAL HEALTH SERVICES **July 2005** the braff group represented the firm	Precision Healthcare, Inc. **July 2005** the braff group represented the firm	NCARE, INC. HOME HEALTHCARE **August 2005** the braff group represented the firm	MediCenter Medical The home of MediCenter Diabetic Supply and MediCenter Home Pharmacy **August 2005** the braff group represented the firm
The Infusion Division of Northwestern Memorial Hospital **September 2005** the braff group represented the firm	The Home Health Care Division of Northwestern Memorial Hospital **September 2005** the braff group represented the firm	HOME MEDICAL **September 2005** the braff group represented the firm	HOME CARE +PLUS+ **October 2005** the braff group represented the firm	PHYSICIANS Preferred HOMEHEALTHCARE **December 2005** the braff group represented the firm

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