marketWATCH

HOME HEALTH & HOSPICE SERVICES

WHILE HOSPICE ESSENTIALLY HOLDS, HOME HEALTH TRANSACTION VOLUME FALLS 47%...BUT DON'T READ TOO MUCH INTO IT

While hospice declined a modest 9%, home health transaction volume fell nearly 50% in the first quarter of 2013 vs. the fourth quarter of 2012. Under normal circumstances, this would be cause for substantial alarm. And, while there have been developments over the past few months that will likely strain the broad homecare deal market over the near to mid-term (see more below), the abrupt decline is not one of them.

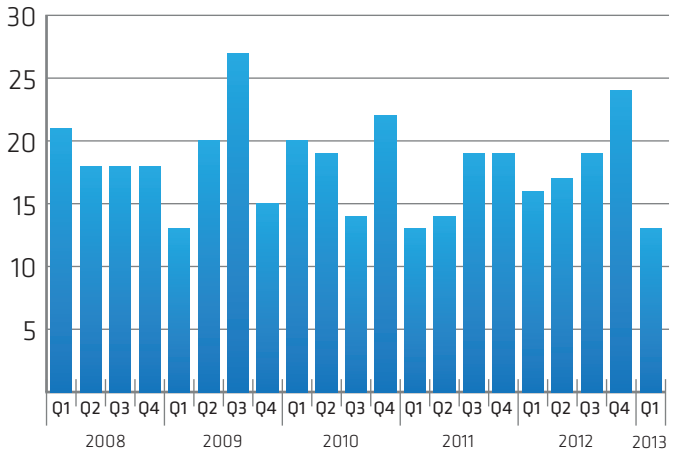
First and foremost, much of the decline is attributable to an artifice of the calendar that drove health care service deal flow (all sectors) to record heights in Q4 2012, and created a vacuum for Q1 2013.

As you may recall from previous editions of ***marketWATCH***, with expectations that the Bush Tax Cuts for high earners would not be extended past December 31st, giving rise to a 5% increase in capital gains tax, and the imposition of an additional 3.8% "surcharge" to help fund health care reform, aggregate capital gains was scheduled to rise from 15% to 23.8%. Consequently, many sellers who may have otherwise contemplated a deal in 2013 accelerated their plans to 2012 to lock-in the more favorable rates. As a result, deal flow surged prior to the year-end deadline. Furthermore, it created an environment where few sellers would entertain a sale at the beginning of 2013. After all, they would have effectively just missed the opportunity to protect 8.8% of their net proceeds – better to hold on until later in 2013, to let the "sting" wear off, and hopefully regain some value with one or two quarters of additional growth.

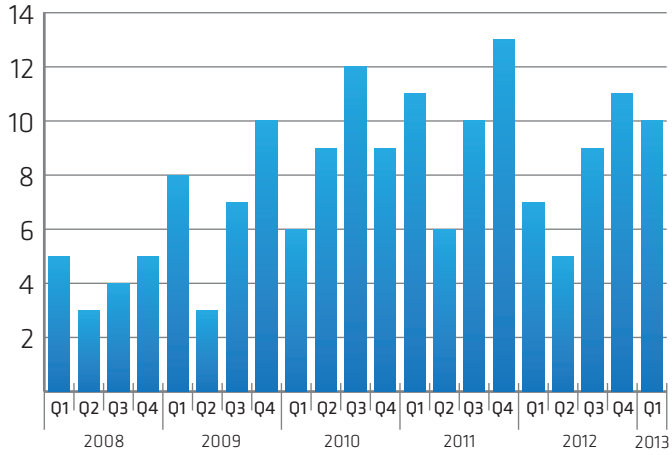
So, the plunge was both predictable – and inevitable.

Furthermore, we anticipate that it will take at least another quarter (or two) before the effect of this "anomaly" fully washes through the M&A pipeline. This, in turn, will make it difficult to read the tea leaves from transaction trends over the near term.

Medicare Home Health Deal Trends



Hospice Deal Trends



Source: The Braff Group

Finally, we should note that as the charts on the previous page indicate, compared to the same period last year (Q1 2013 vs. Q1 2012), Medicare certified home health volume was down a modest 18% and hospice was actually up 43%. Moreover, quarter to quarter, hospice deal flow declined only one deal (which, given the above, could almost be interpreted as a period-to-period increase).

Hospice Developments

The above notwithstanding, from an M&A standpoint, recent news has not been completely benign – particularly for hospice.

Of particular note was the high profile bankruptcy filing of Hospice of San Diego in response to a Medicare audit concerning patient eligibility. With reportedly almost 1,000 patients and $80 million in revenues in 2010, the sheer magnitude of the collapse would have drawn attention. But, what really jolted the industry was the fact that Hospice of San Diego was a highly respected not-for-profit (if the government would target a non-profit, could any for-profit escape intense scrutiny?). Add to the mix that shortly thereafter, the Department of Justice filed a False Claims Act lawsuit against Vitas alleging over utilization of continuous care and improper eligibility (sending the stock plummeting 24%), the sector took a big hit to its public image. This amped up its risk profile and let out just a little bit more air from the hospice "bubble" that had buoyed the sector to record deal flow and valuation from 2010-2011.

The good news? CMS proposed a net 1.1% increase in reimbursement for 2014. And, in a post-sequestration, deficit reduction environment, any increase is noteworthy.

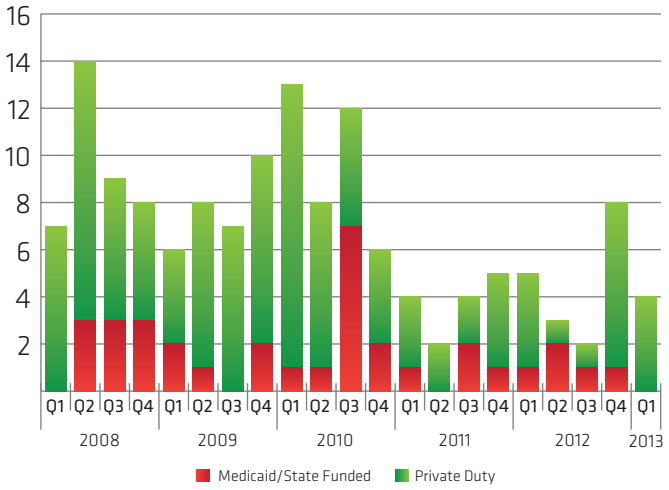
Medicare Home Health Developments

As for Medicare home health, in its annual report to Congress, MedPAC recommended (1) increased oversight to combat fraud and abuse, (2) acceleration of rebasing from 2014 to this year, (3) no reimbursement update, (4) elimination of therapy visits as the basis for reimbursing high-need patients (in favor of a revision to the existing case-mix system), and (5) implementation of co-pays. Usually, such recommendations would jolt the M&A market. However, since MedPAC has essentially made the same recommendations for three years running, an increase to the sector's risk profile has been largely blunted.

Consequently, while buyers absolutely acknowledge these issues – and the increasing difficulty of warding them off, the threats have largely already been "priced" into their valuations (valuations, we might add, that previously slid around 2009/10 when a Medicare home health M&A bubble began to deflate). This stability will likely change though, if (when) one of these threats turns into reality.

Until then, we note that buyers are indeed buying to offset margin declines and stimulate growth. When we combine this with the fact that many of the large players have been sitting on the sidelines for the last several years, and that sellers are reluctantly becoming more comfortable with a pricing environment that is not quite as robust as it once was, the conditions may be emerging for a meaningful spike in deal volume during the latter half of 2013.

Non-Medicare Private Duty and Medicaid / State Funded Home Health Deal Trends



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Source: The Braff Group