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HOME HEALTH & HOSPICE

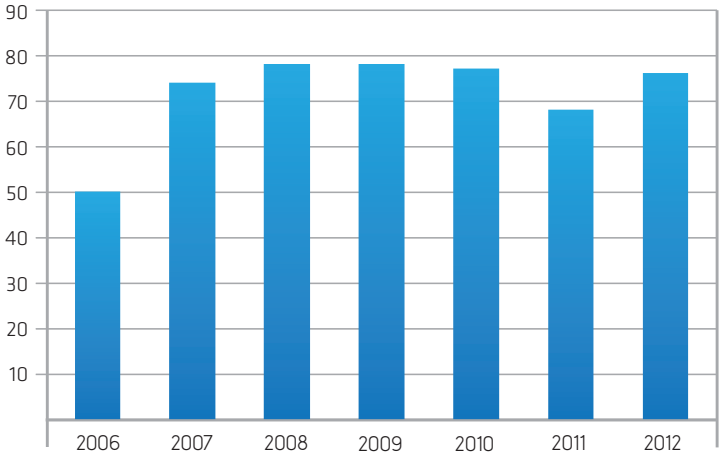
TAX INCENTIVES CONTRIBUTE TO A RECORD YEAR IN HEALTH CARE SERVICE M&A ACTIVITY

With the expiration of the Bush Tax Cuts and the implementation of a 3.8% surtax on capital gains scheduled for December 31st, we predicted a surge in M&A activity in the third and fourth quarter as sellers sought to maximize their post-tax returns. It came as no surprise, then, that after a third quarter that produced the second highest tally of home health, hospice, pharmacy service, home medical equipment, and behavioral health and social service M&A transactions since we began cataloguing deal flow in 2001, the fourth quarter delivered even better results. With a record 106 deals in Q4, 2012 closed out at a new high with 379 deals, up nearly 12% vs. 2011.

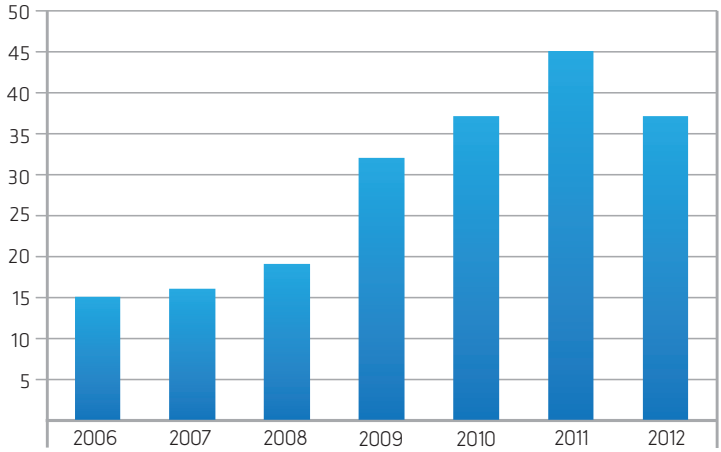
It should be noted, however, that these external tax considerations add considerable "noise" to any trend analysis. Bearing this in mind however, below is our view on home health and hospice M&A activity.

After falling almost 12% from 2010 to 2011 – the first meaningful drop in transaction volume for ***Medicare certified home health*** in four years – the big question entering 2012 was whether or not the fall-off would continue and the Medicare M&A market would crash. After a dismal first quarter, it appeared that the rout might be on. But, alas, during a year of relative quiet (compared to 2011's cloud of SEC, judicial, and senate finance committee investigations), and announced rate cuts for 2013 of less than a half percent (before sequestration), some market confidence was restored. Combined with the tax incentives, that was enough to spur the market to three consecutive quarters of deal growth. As a result, transaction volume in 2012 not only leveled off, but gained most of what it had lost, closing at 76 transactions – just below the record tallies of 78 in 2008-2009. The threats of sequestration notwithstanding (more on this below), our sense is that rightly or wrongly, the feverish anxiety that has characterized home health over the past 12-24 months has been replaced by calm resignation, paving the way for another strong year in deal activity.

Medicare Certified Home Health Deal Trends



Hospice Deal Trends



Source: The Braff Group

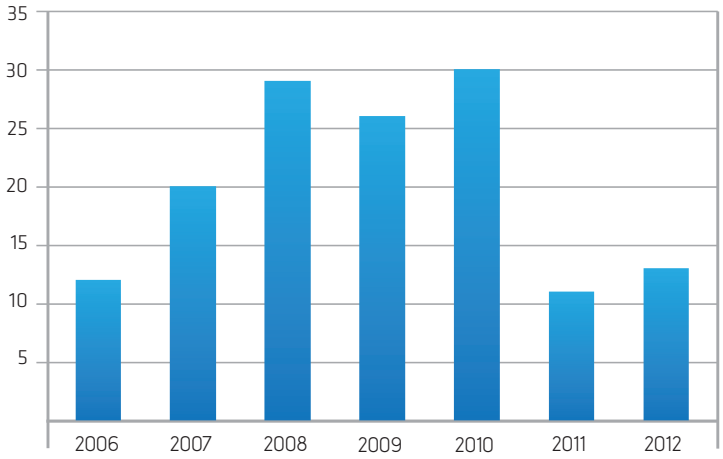
It was a somewhat different story for ***hospice***. Two years ago, The Braff Group predicted that the hospice M&A market was peaking and that the "bubble" would likely burst in 2012. While short of a collapse, hospice transaction activity in 2012 fell for the first time after four consecutive years of solid growth, closing the year down by nearly 18%. The good news is with payment reform initiatives once scheduled for 2013 (that could have brought down the market), now seemingly far in the future, transaction activity is likely to level off at this somewhat reduced pace for the next 12-24 months.

Turning to ***private duty***, while deal volume was up modestly in 2012 – likely due to the tax considerations – the segment remains well below the peak levels recorded from 2008-2010. Notable, however, were the private equity recapitalizations of two of the larger private duty franchisors – Senior Helpers and Griswold Homecare. We have long pointed out that in the owner and relationship centric private duty arena, the favored operating model has been franchising. As these two deals suggest, this sentiment remains in place.

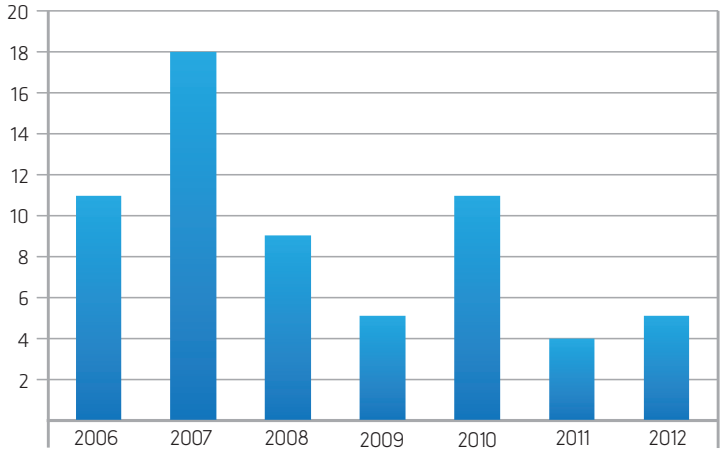
The pattern was similar in ***Medicaid and state funded home care***, with deal volume up slightly vs. 2011. According to the Kaiser Family Foundation, "state tax revenues have grown for eleven consecutive quarters, ***but remain weak***" [emphasis added]. While more states decide to opt in on Medicaid expansion under the Affordable Care Act – most recently Florida and New Jersey – the segment remains under considerable pressure.

One final note. As we went into production of this report, Congress was unable to agree upon a compromise to the budget cutting "sequester." Accordingly, Medicare cuts of 2% are scheduled to begin April 1st. The good news for home health and hospice is that, to most observers, these cuts are far preferable to what could have emerged as an alternative – most ominously, co-pays. The bad news is that issue remains unsettled. And with it, the "risk over-hang" that looms over these sectors.

Private Duty Deal Trends



Medicaid & State Funded Home Health Deal Trends



Source: The Braff Group

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