marketWATCH

HOME MEDICAL EQUIPMENT

DEAL VOLUME ROCKETS 90%; ROUND 2 COMPETITIVE BIDDING RESHAPES M&A STRATEGIES

After a 62% plunge in deal activity as we opened 2013, the question was whether or not the fall-off was more attributable to competitive bid pricing (which came in at a staggering 45% below current Medicare fee schedules), or whether it was a result of an expected slow-down following a "rush" of deals at the end of 2012 (as sellers sought to lock in favorable tax treatment).

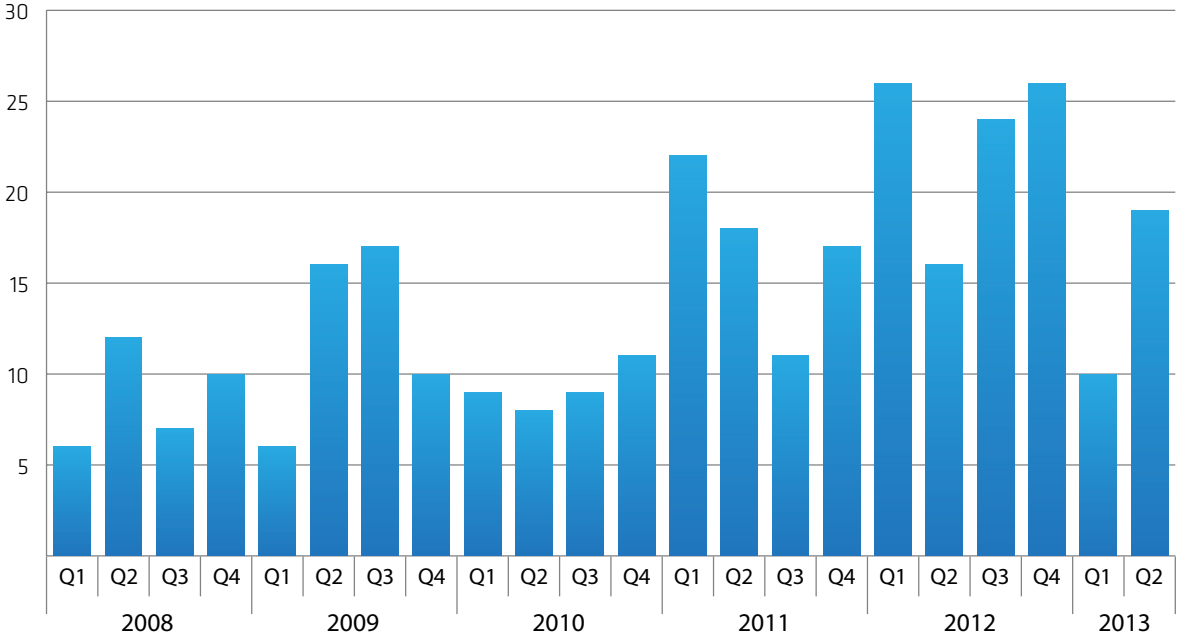
While we acknowledged in our last edition of ***marketWATCH*** that pricing could indeed be a factor, we concluded that it was more likely a reflection of what was being experienced across the entire spectrum of mergers and acquisitions.

Based upon proprietary data collected and analyzed by The Braff Group, home medical equipment transaction volume soared 90% in the second quarter of 2013, pretty much laying to rest the notion that depressed bid pricing would put a stranglehold on the sector and blunt the resurgence of activity that began in 2011.

While the market hasn't gone off the cliff along with pricing, it would appear, however, that competitive ***bidding*** has had an impact on ***strategies, timing, and valuation.***

The holdouts have had enough. For more than 20 years, after every major change in reimbursement – the "six-point" plan, oxygen neutrality, rent-purchase, the assault on nebulizer reimbursement, BBA 1997, MMA 2004, the constant threat of "inherent reasonableness," industry insiders have anticipated a flood of sellers rushing to the market. In reality, however, it never happened. Even after the devastating impact of the 36 month O2 caps, respiratory providers re-committed once again to re-work, re-tool, and re-engineer their businesses to both survive and recapture at least some of the market value that was lost in the regulatory change.

But, not this time.



Source: The Braff Group

Amidst the exasperation of an extraordinarily flawed competitive bid process that practically begged for "suicide" pricing or "bid-to-sell" schemes (more on this below) that CMS deemed reasonable enough to drive median bid prices to breathtakingly low rates, the collective "can-do" spirit of the industry seems to have been widely and palpably pummeled into "can't, and won't-do." We are even beginning to see a smattering of bankruptcies (most recently the high profile filing of Landauer-Metropolitan) that would shake the confidence of even the most optimistic of providers.

So, this time, for perhaps the first time, we are seeing a marked increase in prospective sellers coming to market. Not quite a flood…but more than just a trickle.

Diversification is on. While this development is not new, it is becoming even more widely accepted. In the flight from a singular focus on Medicare, particularly oxygen (even though it arguably remains one of the most profitable product lines), providers (and buyers) are turning towards mobility, supplies, and other narrow niche markets to slow-down the erosion of margin and to capture competitive advantages. We are even hearing, once again, the mantra of "retail sales," the highly touted (but extraordinarily elusive) strategy du jour that captured substantial industry "mind-share" when oxygen caps rocked the market.

Moreover, we anticipate greater interest in pursuing largely Medicaid reimbursed product lines and beneficiaries as this market rides the wave of expansion as a result of health care reform.

Bid-to-Sell Schemes Failed. While we still may see some latent activity, it would appear that plans to win bids just to turn around and sell them didn't work for the very same reason it was so widely attempted. Absent substantial barriers to blanket the nation with bids that were never intended to be filled, there was a glut of "not-so-golden tickets" on the market. Moreover, with the process driving bids so low, demand was far from robust. As a result, the strategy never took hold. Unfortunately, until CMS raises the stakes by requiring winning bidders to fulfill their bids, such attempts to capitalize on competitive bidding will likely continue – and continue to artificially deflate prices.

So tell me something positive. In a sector in which Prozac may understandably outsell the blue pill, the good news is that there are just enough buyers pursuing "Last Man Standing" acquisition strategies to check a free-fall in valuations and deal flow (see The Braff Group's most recent edition of viewPOINTS for more on Last Man Standing initiatives). Accordingly, then,while we're not quite "bullish" on the market, we're definitely not "bearish" either. Call us "cowish."

THE BRAFF GROUP DIFFERENCE

The Braff Group is the leading mergers and acquisition advisory firm specializing in health care services including home medical equipment, infusion therapy, specialty pharmacy, home health care, hospice, behavioral health and social services and health care staffing.

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Atlanta	Atlanta	Atlanta	Atlanta	Chicago	Chicago	Ft. Lauderdale	Palm Springs
888-723-9263	866-455-9198	888-290-7080	888-922-1838	888-290-7237	888-922-1834	888-922-1836	888-922-1833

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