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marketWATCH

HOME MEDICAL EQUIPMENT

HOME MEDICAL EQUIPMENT M&A VOLUME SLUMPS 45% IN 2013

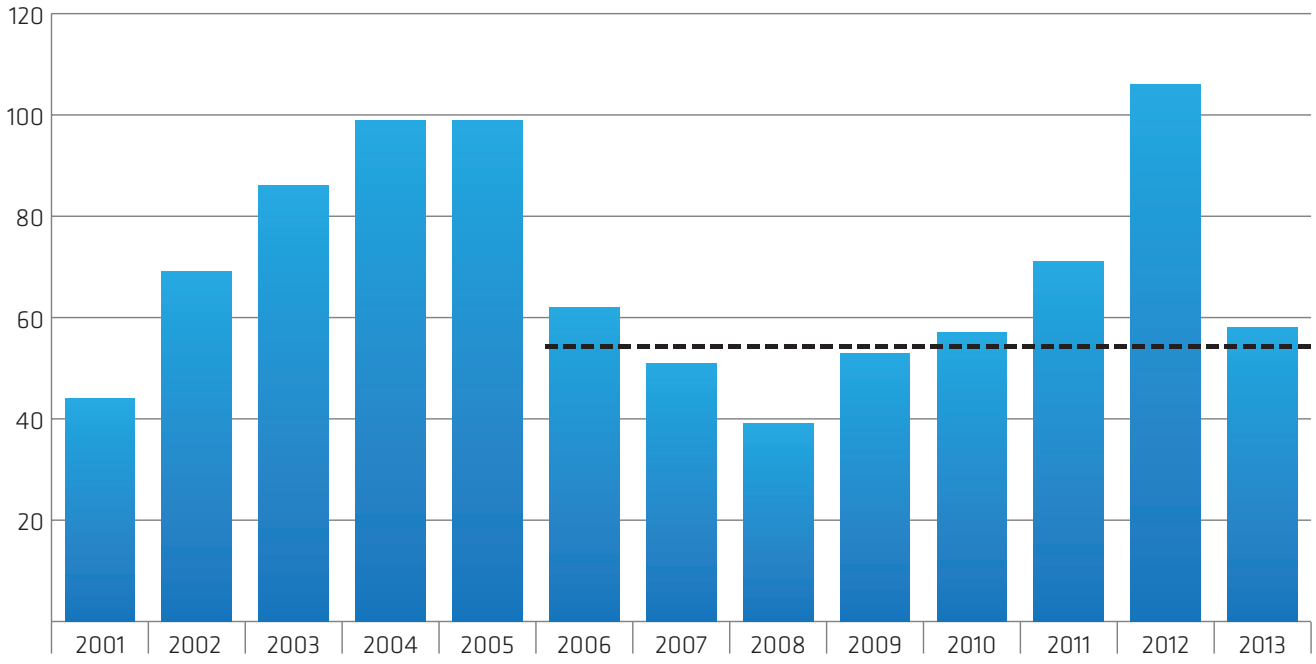
Based upon proprietary data collected and analyzed by The Braff Group, after posting a record 106 deals in 2012, home medical equipment merger and acquisition deal volume plunged 45% in 2013, closing out at 58 transactions. This was largely due to an even greater about-face in private equity sponsored activity which plummeted 67% from a record 42 deals in 2012 to 18 in 2013.

So what can we take away from such an abrupt – and breathtaking — reversal of what had been a four year run-up in sector deal flow?

HME was not alone. Although the home medical equipment sector experienced the greatest overall fall-off in activity compared to all of the sectors that we cover, with the exception of private duty home care, every sector posted declines in 2013. As a result, aggregate health care service transaction volume fell 25% in 2013 vs. 2012. While some of the decline is clearly due to the fact that 2012 activity was artificially inflated as "would-be" 2013 (and beyond), sellers accelerated their divestiture plans to 2012 to capture favorable capital gains treatment that expired at year end, some was likely attributable to a rapidly changing – and increasingly unpredictable – health care policy, delivery, and reimbursement environment.

2013 was bookended by worse than expected competitive bidding developments. 2013 began with a January announcement that Round 2 competitive bid prices came in at an aggregate 45% below the then current Medicare fee schedule, including a stunning aggregate 72% reduction in diabetic supplies reimbursement (and that was for the winners(?)). As the fourth quarter opened, CMS announced that Round 1 re-compete prices (which were due ***before*** Round 2 results were announced) came in at an aggregate 37% below the fee schedule. Less than the

Home Medical Equipment Deal Trends



Source: The Braff Group

45% Round 2 reductions, but more than the 32% cuts extracted in the initial bid. With a trend of escalating discounts (likely driven in no small part by CMS's unwillingness to change bid protocols that practically beg for uncommitted low-ball bids that artificially drive down pricing), the sector's risk profile – which after Round 1, part 1 appeared somewhat contained – took another tick upwards. And as risk rises, buyers re-evaluate.

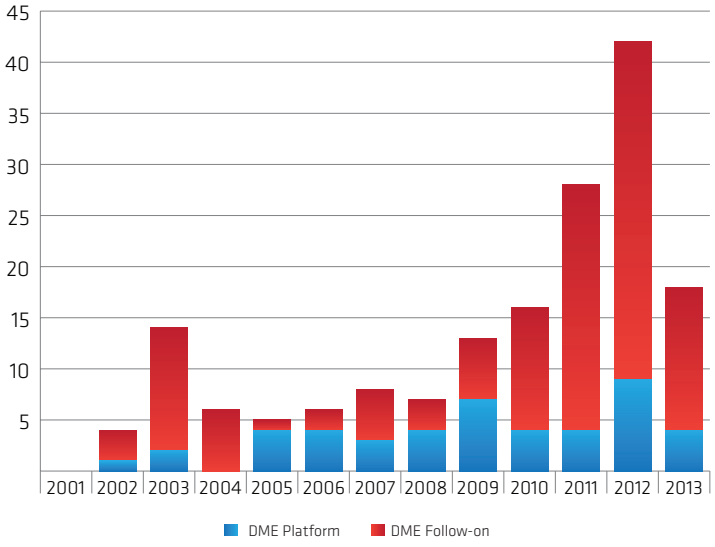
Private Equity: Taking a break? Or reconsidering? After the rapid run-up in private equity sponsored activity that we saw from 2009-2012, it is not particularly unusual for "serial" buyers to take a temporary break to fully integrate their acquisitions, less a growing tower of loosely connected blocks topple upon itself. Alternatively, we've seen similar slowdowns when private equity (which tends to move in waves) collectively reconsiders its investment thesis, and re-trenches to salvage their investment – or contain potential losses. So, in this case, which is it? Time will tell. But suffice to say that with private equity notably absent during the sector's most profitable periods, the recent spate of activity may have been driven by an attempt to capitalize on an extremely disrupted market via a "Last Man Standing" strategy. A difficult strategy, that, among other challenges, may take more time to successfully execute than the three to seven year period PE typically holds an investment (see ***viewPOINTS: Last Man Standing***). Accordingly, it is entirely possible that the new normal might return to the old normal – when private equity left the HME sandbox to long term, well entrenched providers with a high tolerance for pain.

Outlook. When confronted with charts that look like these, it is tempting to conclude that home medical equipment M&A is going down for the count – or at least a long nap. But as frequent readers of marketWATCH already know, while far less robust than during the peak years leading up to 2005, there remains a steady undercurrent of deal flow. Consider that if we exclude the potentially anomalous figures from 2012, the sector has delivered plus or minus 50 deals for eight consecutive years. Volume that, among the sectors we cover, ranks third ***highest*** behind Medicare home health and behavioral healthcare.

So, who's buying and why? Although we may be in the midst of a change in sentiment, private equity sees M&A as the most expedient path to growth within the confines of their investment cycles, so as long as they're in, acquisitions will almost assuredly be part of the mix. With some exceptions, the nationals are pretty much out of the picture. But committed local and regional providers have taken up some of the slack to leverage their infrastructures and extract profits where smaller providers may struggle, to fill in service or bid gaps, or in some cases, to chase fatter margins that remain – at least for now – in non-competitive bid markets. Moreover, as part of an overall risk mitigation strategy, or to favorably distinguish themselves in a market transitioning to multi-discipline, coordinated care, some providers are looking at niche-type deals that expand their product and/or payor mix.

Taken together, while the HME M&A market has dramatically transformed from one dominated by a relatively small number of national buyers chasing one product category (respiratory), to one made up of a far larger, eclectic mix of buyers targeting an equally eclectic mix of products and services, there is enough of this "new-wave" activity to support annual volume of +/- 50 deals for the foreseeable future.

Private Equity Investment Trends in Home Medical Equipment



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Source: The Braff Group