the braff group

marketWATCH

HOME MEDICAL EQUIPMENT

HOME MEDICAL EQUIPMENT M&A TRANSACTION VOLUME FALLS 62%...

REACTION TO ROUND 2 BIDDING PRICES? MAYBE...BUT MAYBE NOT

Home Medical Equipment merger and acquisition transaction volume plunged 62% in the first quarter of 2013 vs. the fourth quarter of 2012.

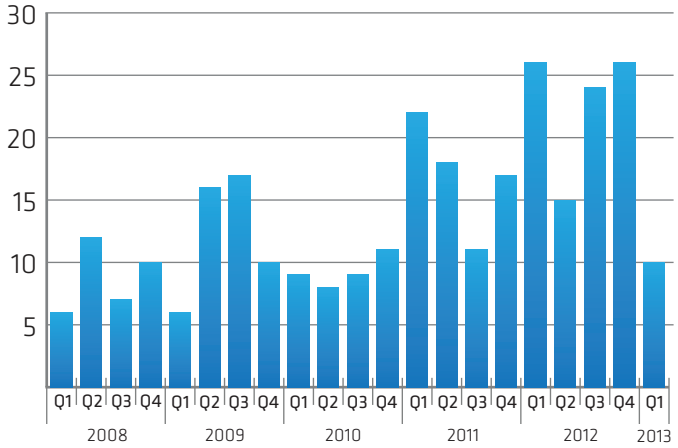
With the fall-off occurring at the same time CMS announced average Round 2 competitive bidding cuts of 45%, it would be natural to attribute the decline to this development.

But, a closer look at the proprietary M&A data collected and analyzed by The Braff Group reveals that every other sector that we cover also recorded substantial drops in transaction volume (even if we exclude the HME results, the average slump was 42%). Moreover, we note that there were two new private equity sponsored HME platform investments during the first quarter of 2013 – an indicator of enthusiasm, rather than retreat.

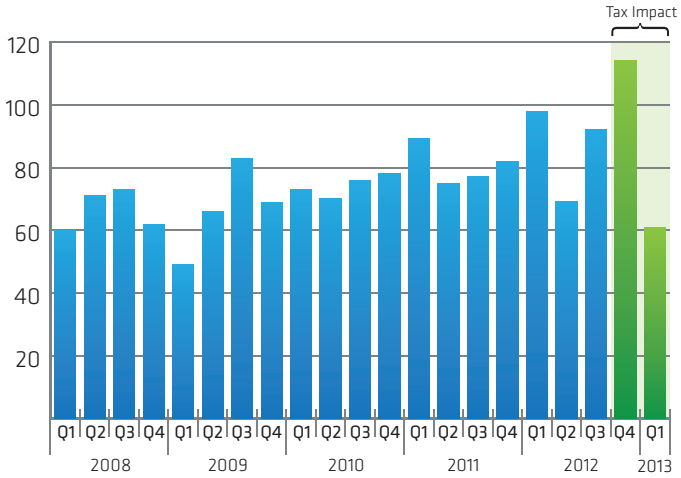
So, if private equity is still investing in HME, and the decline is not limited to the sector, what explains the widespread and striking slide?

As it turns out, much of the decline is attributable to an artifice of the calendar that drove deal flow to record heights in Q4 2012 – including HME, and created a vacuum for Q1 2013.

Home Medical Equipment Deal Trends



All Health Care Services Deal Trends



Source: The Braff Group

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, even without the announcement of competitive bid prices, a 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.

So, should we conclude that Round 2 competitive bidding will have no impact on M&A activity? Not at all. It's just that coming off Round 1 cuts of 32%, and the very real possibility that Round 2 cuts could indeed be greater, we suspect that at least a portion of the additional 13% in cuts (on average) had already been factored into the home medical equipment M&A market. Accordingly, while the pricing was below what many expected, and may have some lingering impact on deal activity over the short term, we do not anticipate that it will send the market into a sustained, long term, trough.

The Value of the "Golden Ticket"

Despite the cuts, the right to participate in a closed market (e.g. a winning bid) has value. The question is how much?

A significant challenge here is that the home medical equipment industry has very little experience in buying and selling these kinds of rights. By comparison, there have been numerous sales of licenses and certificates of need in home health and hospice. But even in these sectors, where there is at least some history of activity that gives buyers and sellers clues to the value of these entirely intangible assets, the variation in pricing is extraordinary.

Depending on the attractiveness of a market, the scarcity of opportunity to compete in it, and the strategic importance an individual buyer places on establishing a presence there, we have seen these "golden tickets" sell for as little as $250,000 (essentially a reflection of the time and intellectual/administrative efforts invested to obtain these rights), to $5,000,000 and more (reflecting highly speculative – but often real – long term economic returns, resale value, and competitive advantage).

So, what is the takeaway for the HME industry?

If the range in value for participation rights is as wide as we have seen in home health and hospice – a far more developed M&A market, HME buyers and sellers should anticipate the same (and more). As such, self serving as it may sound, the only way to flesh out the value of a particular winning bid is to orchestrate a strategically developed and competitive offering process.

Or, you can cross your fingers.

Call us to see how we can put our experience to work for you.

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