the braff group

# marketWATCH

## HOME MEDICAL EQUIPMENT

## AMIDST A WIDELY FELT FALL-OFF IN ACTIVITY, HME M&A SLIDES 25% IN Q1

Based upon proprietary mergers and acquisitions data collected and analyzed by The Braff Group, home medical equipment transaction volume fell from 16 deals in Q4 to 12 in Q1 – 25% drop-off.

While we have documented systemic issues that have blunted HME M&A activity – particularly worse than anticipated competitive bid results, and, a marked retreat by private equity — it's worth noting that the first quarter of 2014 produced M&A declines in a wide sampling of trend indicators. Consider the following:

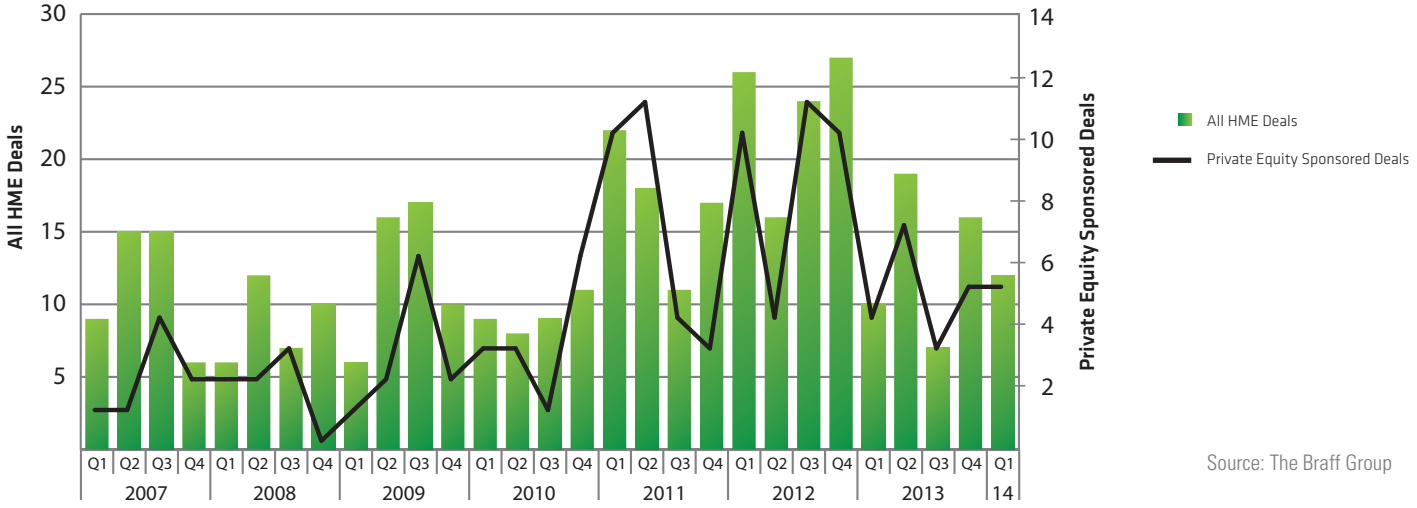
- **Based upon data collected from Thomson Reuters, overall middle market (below $500M) mergers and acquisitions activity fell 14% in the first quarter of 2014.**
- **According to Pitchbook Platform, a firm that tracks private equity transaction activity, PE deal volume overall fell 7% in Q1.**
- **Based upon our own proprietary data, aggregate deal volume for all of the health care service sectors that we track (home medical equipment, home healthcare, hospice, pharmacy services, behavioral health and social services, and healthcare staffing) fell 20%, from 99 deals in Q4 to 79 in the first quarter of this year.**
- **Similarly, our data shows that private equity investment activity in Q1 across all these sectors fell 13%.**

So, what should we make of all of this?

While we'd love to proffer some compelling insight to explain this widely felt downturn, the fact of the matter is that, beyond some strained and pained parsing of largely anecdotal observations, there is simply little out there to decode the malaise.

**In fact, there is far more evidence to predict an upswing than there is to explain a downturn.**

### Home Medical Equipment Transaction Trends




Source: The Braff Group

If we were inclined to pundit a rationale (as others have), we could opine that the first quarter is a consequence of a dearth of sellers created after the remarkable run-up in deal flow at the end of 2012 to capture favorable capital gains treatment. Or, we could suggest (as others have) that the market continues to reflect a sluggish economy or uncertainty regarding wage and tax policy. Or, as it relates to healthcare market conditions, we can re-cycle (as others have), the old stand-by of uncertainty regarding health care reform.

While all of the above *has* had an impact on M&A, their influence has largely been flushed through the transactional pipeline by now. We're more than 15 months past the great tax rush of '12. The sluggish economy has been sluggish for more than five years. As for health care reform? After supreme court rulings, eight million signups, and the veto power of a Democratic president for at least 30 more months, regardless of your political position on the matter, it's becoming increasingly unlikely that, at least, the core elements of health care reform – and their impact on the economy and health care delivery – will not be in place for the foreseeable future.

On the "B" side of this record, we have a rocking stock market with seemingly no end in sight. Gads of private equity money sitting around un-invested and just waiting to produce "Wolf of Wall Street" returns. Debt markets that are opening up to levels we haven't seen since the market melt-down in 2008. And giddy optimism that values technology companies with zero revenues at billions of dollars.

That's why the conventional wisdom among M&A observers is that, despite a sluggish start, market conditions are increasingly ripe for a strong year. Conditions, we might add, that may help offset some of the challenges facing the HME sector.

## The HME M&A Market in One Company

Sometimes the operating strategy of a single company can be a metaphor for an entire industry. Such is the case with recent actions taken by Wright and Filippis, a well-known market leader based in Michigan. Over the past year, the company has divested its diabetes supplies business and has acquired an orthotics and prosthetics provider in South Carolina. Two moves that say a lot about the direction in home medical equipment.

First, we've long been reporting that regional providers are increasingly leading the charge in HME mergers and acquisitions. Enter Wright and Filippis.

Second, their divestiture of the diabetics business almost assuredly reflects the challenges – and shrinking margins – of post-competitive bidding methodologies and resultant pricing.

Third, the sale and subsequent acquisition of the SC O&P business reflects the movement away from products subject to commoditization (and, hence, ripe for competitive bidding), towards more clinically focused, margin insulated, specialty niches, such as orthotics and prosthetics and complex rehab (another W&F product line). As quoted in the June issue of HME News, commenting on their recent activity, A.J. Filippis said "It's [complex rehab and accessibility] outside of competitive bidding and there's a real need for (these services). O&P is heavily clinical and so is rehab. We see that as tying right in."

Finally, with the move into South Carolina, it's first out-of-state transaction, it would appear that Wright & Filippis is looking to leverage and export its strength in this narrow niche to open up new markets for growth in non-competitive bid products and services – right (Wright?) out of the highly acquisitive complex rehab consolidators playbook.

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