The long run of consolidation activity in the home medical equipment sector is a testament to the industry’s ability to re-imagine and re-configure merger and acquisition strategies to adapt to, and prosper under, ever-changing market conditions.

Beyond Medicare Oxygen. Don’t get us wrong here. Buyers still love Medicare oxygen revenues - Medicare for its quick cash turnover and oxygen for its uncapped, sustained profitability. It’s just that after contending with a near unending string of price cuts - the latest being MMA inspired FEHBP reductions announced earlier this year - buyers are finally beginning to not dislike non-Medicare and non-oxygen services as much as they have in the past. We have even heard buyers mention the “D” word of late. That is, the value of Diversifying their portfolio – at least to some degree – away from a strict reliance on Medicare and/or oxygen. While far from a stirring endorsement, this shift in attitude has had a remarkable impact on merger and acquisition activity in recent months. No longer does a firm have to generate 60-70% of its revenues from respiratory products and services to attract acquisition attention (a mix of 40-50% will now often suffice). As long as reimbursement is at least plus or minus $150.00 per month (uncapped), buyers are increasingly less likely to substantially discount the M&A value of oxygen revenues and profits derived from managed care and/or private insurance. Moreover, we have even seen buyers acquire firms that focus on providing oxygen to skilled nursing facilities, a specialty, which, in the past, has been actively avoided.

Infusion Moves up the Priority List. While it would be an overstatement to suggest that, from a merger and acquisition perspective, home infusion therapy is the “new oxygen”, it is the product line which has seen the most dramatic increase in acquisition interest over the past year. There are several key reasons for this. First, consistent with the theme suggested above, infusion therapy offers home medical equipment providers substantial diversification away from Medicare and oxygen in a product environment in which they are (a) already in, and/or (b) comfortable with. Second, as buyers become larger and the pool of oxygen focused acquisition candidates gets smaller, it is increasingly difficult for firms to rely solely on HME providers to achieve increasingly ambitious
growth targets. Having largely been relegated to the M&A sidelines since the market peaked in the mid 90’s, the IV sector offers a wealth of acquisition opportunity. Third, and perhaps most importantly, with Medicare beginning to cover home infusion therapy drugs in 2006 as part of the MMA prescription drug package, if the infusion industry is successful in convincing regulators to pattern the benefits after those currently in place in many Medicare Advantage programs (Medicare Part C) or have the benefit shifted to Part B (either of which many believe possible), infusion therapy could prove to be an extraordinary - and perhaps the most significant - growth engine for providers over the near term.  

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Managed Care Makes a Comeback. Once again, turning to the Medicare Modernization Act, one of the most important health care economic policies embodied - and advanced - by the legislation, is the reallocation of dollars away from government run Medicare Fee For Service (FFS) to privately administered Managed Care Organizations (MCOs). To facilitate such a shift, under the MMA, MCOs received substantial increases in payments, enough so that according to Urban Institute senior fellow Robert Berenson MD, compared to traditional Fee for Service plans, under the MMA, payments to Medicare Managed Care plans on average are 16% greater than FFS (as an aside, it should be noted that immediately after the MMA was passed, one of the most active sectors in health care mergers and acquisitions was in the HMO/Managed Care arena as companies sought to acquire more capacity - and more lives - to take advantage of such favorable reimbursement). Many observers believe that unlike the last incarnation of managed care - where overly restrictive access for patients and excessively low and equally slow payments for providers insured its demise - the lucrative kick-start combined with lessons from the past bodes well for success this time around. Subsequently, revenues attributable to managed care are no longer being shunned by buyers in the M&A market. Moreover, in select situations buyers are beginning to target firms with managed care contracts, both for the opportunity to capture more revenues as more beneficiaries move into these plans and to gain the experience and expertise necessary to develop profitable programs of their own in other markets.

M&A Value of Nebulizer Medications Re-Emerge...For Now. In the immediate aftermath of the MMA (2004), when it was unclear whether or not anything could (or would) be done to mitigate the Average Sales Price plus 6% pricing methodology set to begin in 2005, the merger and acquisition value of this product line plummeted to near zero. By the end of 2004, however, the industry won a crucial battle to obtain dispensing fees in addition to the ASP plus 6 reimbursement. Not surprisingly, while values have not (and likely never will) reach pre-MMA heights, buyers are once again ascribing value to nebulizer medications - a development that has enabled sellers that derive substantial revenues and profits from these products to once again re-enter the M&A market. This said, with CMS once again scrutinizing dispensing fees and the OIG releasing, what appears to be a flawed (see sidebar), yet nevertheless damaging report challenging the volume of services provided by inhalation medication suppliers, this re-emergence may prove short-lived.

Leveraging Nebulizer Platforms Into Other Product Lines. While the profitability - or potential lack thereof - hung in the legislative balance for much of 2004, buyers with large, established nebulizer medication programs did not sit by idly awaiting the final outcome. Rather they recognized that the nebulizer customer management, product procurement, billing, and delivery infrastructure could be leveraged to support other product lines with similar market characteristics. Accordingly, over the past 12 months we have seen buyers selectively target diabetics suppliers and other specialty product providers that serve patients with chronic conditions.

The Impact of Competitive Bidding. While the specter of competitive bidding looms over the industry as we move closer to the initial roll-out in 2007, from a merger and acquisition standpoint, it has had limited impact to date. As of this writing, absent the identification of (a) the first 10 MSAs to be included and (b) a fully developed and articulated basis upon which winners will be selected (paramount of which is service coverage requirements), there is
simply not enough information necessary for providers to significantly factor competitive bidding into their M&A planning. On the periphery however, we have seen certain buyers favoring - though not necessarily aggressively targeting - markets in which they (a) anticipate competitive bidding may be implemented and (b) have coverage gaps. Similarly from the seller’s perspective, for companies located in large potential first-round MSAs that have seriously contemplated a sale for other business, financial, and/or personal reasons, competitive bidding likely has tipped the scale for some in favor of a sale.

Once the competitive bidding MSAs and guidelines are announced, however, we anticipate a surge of activity in these markets as committed firms seek to round out their capacity, as necessary, to position themselves to bid successfully. The larger question, the one that will have a dramatic impact on valuations in these bid areas, is how the delicate balance of supply and demand – one which arguably favors sellers today – will play out. With an expected increase in acquisition demand, it is also reasonable to expect an increase in potential sellers that are ill-suited or unwilling to participate in competitive bidding. If the increase in demand is equal to, or greater than, the increase in supply, valuations will hold, or tick upwards respectively. If, however, a wave of sellers floods the market, valuations could suffer. But that is a big “if”, one that will depend, in part, on the role (or lack thereof) apportioned for smaller providers in the competitive bidding programs. Furthermore, if ever there was an industry capable of adapting to seemingly un-adaptable initiatives, it is the home medical equipment industry. Accordingly, counter to predictions of mass exodus, we suspect that providers that have the energy and enthusiasm to persevere will find opportunities to do just that.

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GAO Releases Study of Services Provided by Inhalation Drug Suppliers

In September 2005, the Office of the Inspector General released a report entitled “Review of Services Provided by Inhalation Drug Suppliers” that concluded that “beneficiaries, on average, receive little service from their inhalation drug suppliers beyond contacting them to ask if they need a drug refill”. In describing the scope of the study however, OIG reported that “this inquiry does not address pharmacy, delivery, billing, and other activities that suppliers perform to provide drugs and that also drive their cost of doing business [emphasis added].” Commenting on this analysis in a press release dated September 30, 2005, the American Association for Home Care stated that while these services “were not included in the OIG study, they constitute most of the cost of dispensing inhalation drugs. To illustrate this point, reference can be made to the Government Accountability Office (GAO) Study of October 2004, “Appropriate Dispensing Fee Needed for Suppliers of Inhalation Therapy Drugs,” (p. 9). The GAO collected cost data on various inhalation dispensing fee services, and the core services above accounted for about 85 percent of the cost of the total services rendered. It is not surprising that the OIG concludes that only a limited number of services were provided when they captured only about 15 percent of those services and related costs in their survey instrument.”
About The Braff Group

The Braff Group is a leading middle market merger and acquisition firm that specializes in the home medical equipment, home health care, hospice, staffing, specialty pharmacy, infusion therapy, and eHealthcare market sectors. The firm provides merger and acquisition representation, strategic planning, and valuation services.

For the second consecutive year, The Braff Group was recently honored as one of the fastest growing companies in the Pittsburgh Region by the Pittsburgh Business Times in its annual ranking of the 100 fastest growing privately held firms in the area. Additionally, The Braff Group was awarded the 2004 Life Sciences (Biotech/Healthcare) Deal of the Year by the M&A Advisor, a leading publication dedicated to middle market merger and acquisition activity, for our representation of LifePlus, a regional home care provider based in Raymond, NH.