Wall Street's View of the Home Health Sector

BY DEXTER W. BRAFF

Wall Street is all about money. And to "The Street," anything less than a billion dollars in value is pocket change. No surprise then that when analysts are asked about home health care, they immediately think about home medical equipment providers like *Lincare* and *Apria,* with market capitalizations of \$3.1 billion and \$1.5 billion, respectively.[1] With substantially smaller market caps, publicly traded nursing providers such as *Gentiva, Amedisys, National Home Health Care,* or *Almost Family* have traditionally been overlooked. But for the reasons discussed below, over the past few years Wall Street has begun to take note of the "real" home health sector — a view that continues to pick up positive momentum.

Hospice afterglow shines brightly on home health. Over the past two years, with CMS pushing for increased hospice utilization, and after two extremely successful IPOs (Initial Public Offerings), the darlings on Wall Street have been hospice providers *Odyssey Healthcare* and *VistaCare.* As such, the investment community is eagerly looking for the "next big thing." And with similar market dynamics, greater fragmentation (which provides substantial growth opportunities), and a substantially larger market size, home health is moving into the spotlight.

The MMA creates market stability. Wall Street avoids risk, especially when it is: a) unpredictable and b) unquantifiable — which is pretty much what you get in a reimbursement climate that reflects the vagaries of federal and state budgets, the economy, and the political landscape. Under the Medicare Modernization Act (MMA), however, Medicare-certified agencies will receive market basket *increases* (less eight tenths of a percent) through 2006. While the investment community understands that this could change as a result of mounting deficits (as well as a substantially higher price tag for the MMA than originally anticipated), the time frames are now more clear, and the scope of the risk is relatively contained. As such, the home health care market is currently about as stable as it gets — and arguably substantially more stable than virtually any other health care service sector.

Stock prices for home health have substantially outperformed the Broad Markets for more than four years running. Since February 2000, while The Braff Group's Broad Market Index has fallen 26 percent, the TBG Home Health Index has soared 296 percent — the greatest growth of all sectors we track.[2] Most recently, over the 12 months ending March 31, 2004, the Market Value of Invested Capital (MVIC)[3] for *Amedisys,* the largest publicly traded provider of Medicare-certified services, has grown 355 percent, and carried a value of 16 times EBITDA,[4] comparable to then-current hospice valuations. These are performance indicators that Wall Street simply cannot ignore.

[1] Market capitalization is calculated as total shares outstanding times stock price; values quoted are as of March 31, 2004.

[2] The Braff Group Index measures the stock performance of 40 companies in seven key health care sectors: Home Medical Equipment, Home Health Services, Specialty Pharmacy and Infusion Therapy, Hospitals, Long-term Care, eHealth, and Health Care Staffing. The Home Health Care sector is comprised of *Gentiva, Amedisys, National Home Health Care, Almost Family,* and *Pediatric Services of America.* The Broad Market Index is comprised of the Dow Jones Industrial Average, the NASDAQ Index, and the S&P 500. All stocks were indexed to 100 on February 29, 2000.

[3] The "MVIC" is calculated as total shares outstanding "x" stock price, less cash, plus interest-bearing debt.

[4] Earnings Before Interest, Tax, Depreciation, and Amortization.

Home health care is not technology. Although government-reimbursed health care is still risky, it has also been marked by extraordinary, predictable, and growing patient demand. To investors still recovering from the dot-com bust of 2000, home health care feels a whole lot safer than the technology market.

With all of these positive factors in play, you might expect home health to be the toast of The Street. Perhaps it would be, if not for one critical factor. As indicated above, all of the publicly traded home care firms are relatively small with market valuations below $500 million. This creates difficulties for many institutional investors and mutual funds that, due to their large size, regularly need to move (buy and sell) large blocks of shares. First, institutional investors and mutual funds generally cannot invest enough money in these "micro" to "small-cap" funds to make an appreciable difference in their portfolio performance. Second, even if they could, a large transaction volume in and of itself could significantly drive up prices when buying, or significantly drive them down when selling, thereby lowering their returns.

So until firms in the home health sector grow large enough to accommodate substantially greater trading volume, they are somewhat "off limits" to some of these most coveted investors. As such (and further complicating matters), micro and small-cap firms like those in home health traditionally attract limited "coverage" by analysts who play a crucial role in creating awareness — and thus stimulating interest — in their firms, which, in turn, often drives trading volume and price. However, the good news is that more analysts are beginning to cover home health, substantially increasing the sector's profile. With continued growth, the home health sector will indeed become an increasingly attractive option to a wider range of investors.

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