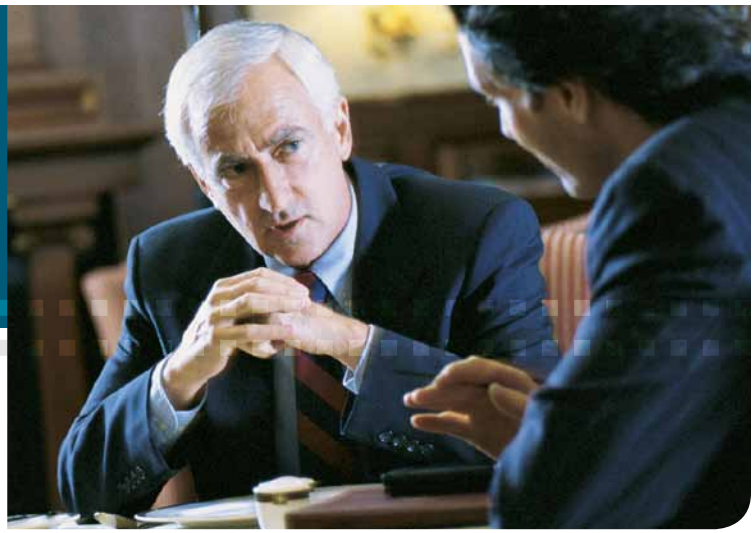
the braff group



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PERSPECTIVES

2011 FIRST QUARTER

HEALTH CARE SERVICE M&A ACTIVITY UP 9.2%

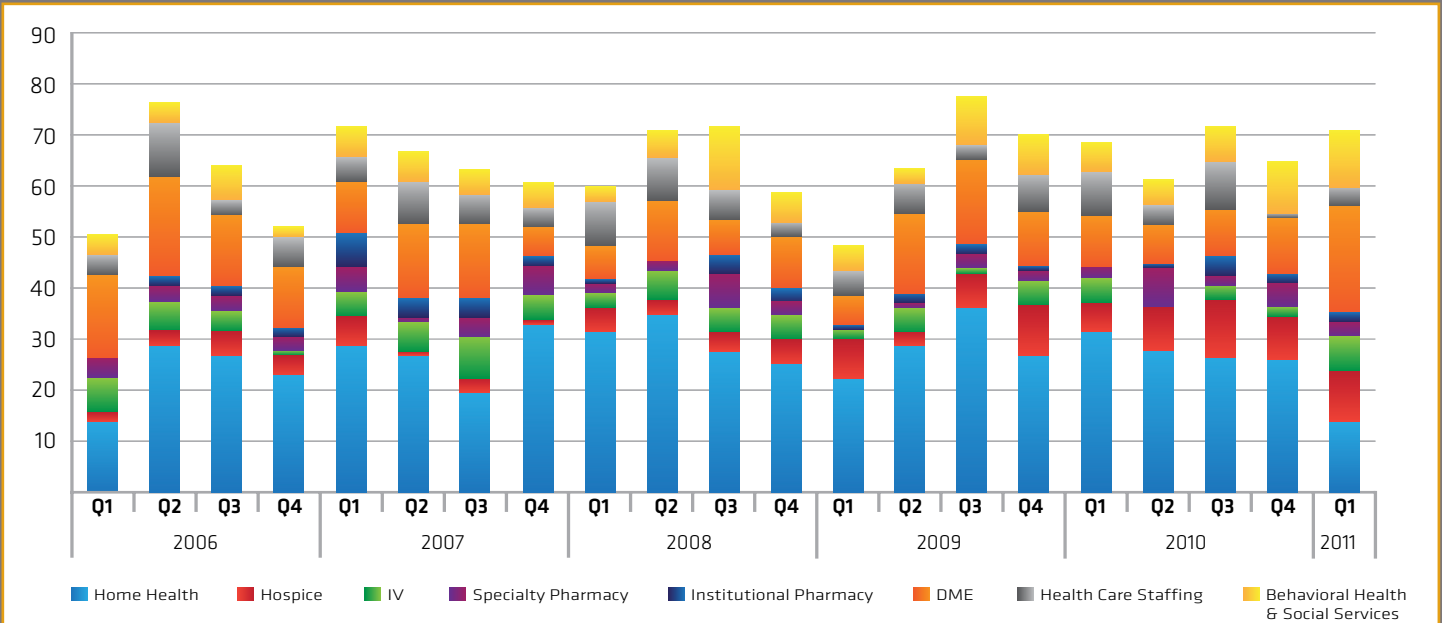
According to proprietary research compiled by The Braff Group, the first quarter of 2011 got off to a good start with 71 transactions, up 9.2% over the prior quarter's 65 deals and up 2.9% over the same period last year.

The biggest gainers during the quarter were the infusion therapy, home medical equipment and health care staffing sectors, offset largely by a substantial decline in the home health care arena.

On a macro level, much occurred in health care services over the quarter.

From a reimbursement perspective, on the heels of a 5% cut in reimbursement which went into effect January 1st of this year, MedPAC recommended accelerating rate cutting re-basing and instituting a patient copay for Medicare home health, sending chills throughout the industry. At the same time, as stimulus funding for Medicaid nears a June 30, 2011 termination point, states across the country were scrambling to find ways to reduce their spend on these programs – with Texas, for example, starting with an opening salvo of reductions approaching 30% (though they are likely to end up below 10%). On the home medical equipment front, the second incarnation of the first round of competitive bidding was initiated on January 1st, with pricing averaging more than 30% below the pre-bid Medicare rates. At the same time, the industry seemed to gain momentum regarding the flaws in the bidding program based upon a scathing report on the process endorsed by 166 economists, computer scientists, and operations researchers that was released in the fourth quarter of 2010.

OVERALL HEALTH CARE SERVICE M&A ACTIVITY



* Source: The Braff Group Through 1Q 2011

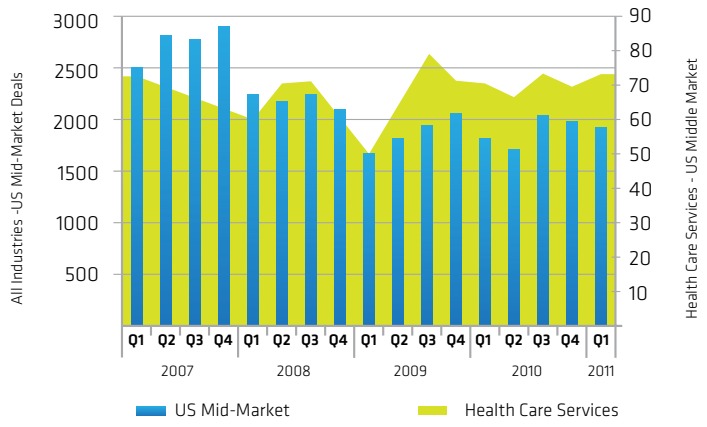
FIRST QUARTER 2011 M&A ACTIVITY

Sector	4th Qtr. 2010	1st Qtr. 2011	% Change	1st Qtr. 2010	1st Qtr. 2011	% Change
HHA-Medicre Certified	20	10	-50.0%	20	10	-50.0%
HHA-Medicaid	2	1	-50.0%	1	1	0.0%
HHA-Private Duty	4	3	-25.0%	11	3	-72.7%
Hospice	9	10	11.1%	6	10	66.7%
Staffing	1	4	300.0%	8	4	-50.0%
HME	10	21	110.0%	9	21	133.3%
Infusion Therapy	2	7	250.0%	5	7	40.0%
Institutional Pharmacy	2	2	0.0%	-	2	-
Specialty Pharmacy	5	3	-40.0%	3	3	0.0%
Behavioral Health	10	10	0.0%	6	10	66.7%
Total	65	71	9.2%	69	71	2.9%

Alas, to say there was a lot of uncertainty in the air would be an understatement. Yet with some exceptions, transaction activity was far more resilient than overall market conditions would suggest. Perhaps counter intuitively, private equity, which typically abhors uncertainty, invested heavily during the quarter, with 25 transactions (7 platform and 18 follow-on transations), the highest total since the record total of 28 set in the 3rd quarter of 2007. This likely represents a strategic play to capitalize on markets influx to quickly capture share and create critical mass. With lots of un-deployed cash and increasingly favorable debt markets (particularly to finance deals with EBITDA in excess of $10M), private equity may continue to exert its influence on the health care service M&A market over the balance of 2011.

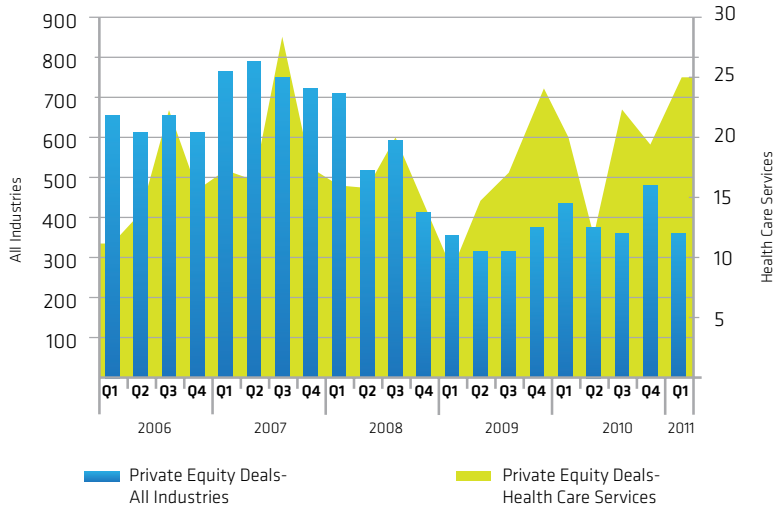
The biggest surprise of the quarter was the substantial increase in deal flow in the home medical equipment sector. The 21 deals completed was the highest number since the fourth quarter of 2005, which, with the passage of the Deficit Reduction Act of 2006 and the institution of a 36 month cap on oxygen reimbursement, marked the "end" of the sector's extraordinarily robust and long consolidation period (see inside for further details). We also note that after a lackluster 2010, home infusion therapy got off to a great start with 7 deals in the first quarter, up substantially over the two completed in the fourth quarter of last year. With all the uncertainty in home health – particularly in Medicare and Medicaid – it is little surprise that all the home care segments (Medicare, Medicaid, and Private Duty) recorded declines as 2011 unfolded. Perhaps more than any other sector, we expect substantial and continued volatility in Medicare home health as buyers and sellers alike struggle to determine just how far, and how fast, margins – and profitability – may shrink over the next 12-36 months.

US Middle Market vs. Health Care Services Deal Trends



While overall middle market M&A activity for all industries fell for the second straight quarter, health care service deal flow rose more than 9% in the first quarter of 2011. With the economic recovery still somewhat tepid, demand resistant health care – even in the midst of payment reform – remains an attractive M&A play.

Private Equity Deal Trends for All Industries vs. Health Care Services



The attractiveness of health care is no more evident than in the comparative private equity investment activity in health care services vs. all industries over much of the past eight quarters.

* Source: The Braff Group Through 1Q 2011

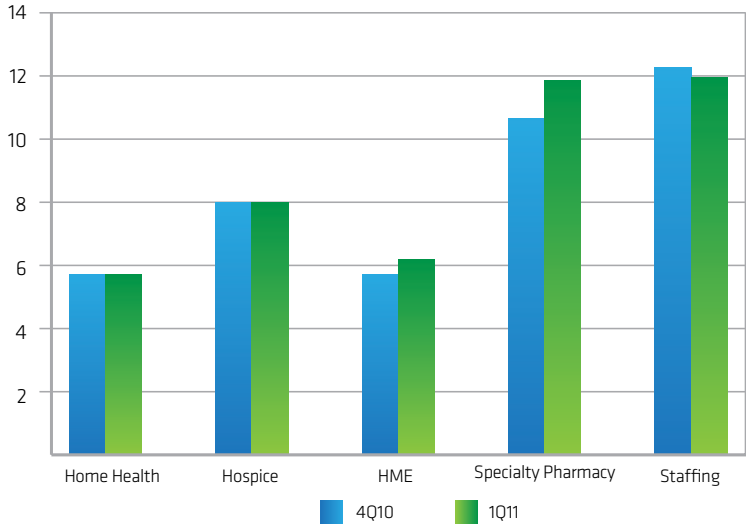
THE PUBLIC MARKETS

The Braff Group Index

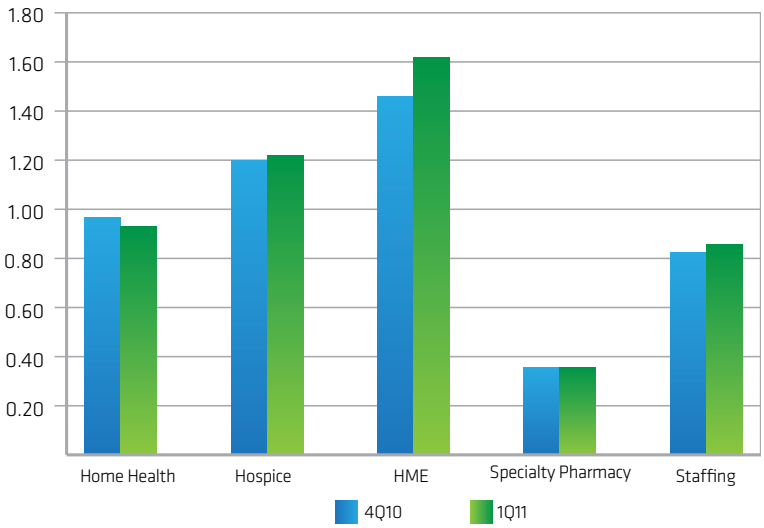
Period	Broad Market Average	HME	HHA & Hospice	Specialty RX & IV	Health Care Staffing	Hospitals	Long Term Care	eHealth	TBG Composite	Spread
Q109	55.4	75.9	564.8	69.4	28.8	117.3	113.6	62.0	181.6	126.2
Q209	63.3	86.1	687.3	131.0	35.5	158.5	218.5	95.4	241.8	178.6
Q309	72.8	112.3	865.7	142.2	50.0	193.8	336.8	108.3	307.2	234.4
Q409	77.6	122.0	1018.9	170.5	52.4	204.7	291.0	116.3	359.2	281.6
Q110	81.3	150.5	1017.2	163.0	52.2	225.1	307.3	118.2	365.0	283.8
Q210	72.3	193.5	934.8	106.9	41.7	215.2	267.5	105.3	332.8	260.5
Q310	80.2	161.5	721.5	105.2	35.9	217.4	313.7	116.1	285.4	205.3
Q410	87.6	172.8	930.1	106.7	48.2	246.2	400.2	131.5	353.5	265.9
Q111	92.6	210.6	947.6	95.3	54.9	271.2	569.5	153.3	386.5	293.9
QTR. CHANGE	**5.7%**	**21.9%**	**1.9%**	**-10.7%**	**14.0%**	**10.1%**	**42.3%**	**16.6%**	**9.3%**	**10.5%**
YEAR CHANGE	**14.0%**	**39.9%**	**-6.8%**	**-41.6%**	**5.3%**	**20.5%**	**85.3%**	**29.7%**	**5.9%**	**3.6%**

2011 got off to a great start as every sector, except Specialty Rx and IV, posted gains in the first quarter, contributing to a 9.3% increase in The Braff Group Health Care Service Composite Index. Leading the way was Long Term Care, which surged 42.3% largely on gains by Sunrise Assisted Living as it continued a successful recapitalization strategy, and Home Medical Equipment, which posted a gain of 21.9% on increased enthusiasm for Rotech. Health care services remains an attractive, counter-market investment strategy as the spread between the TBG Composite Index and our Broad Market Index grew 10.5% over the quarter. From a valuation perspective, as the charts below suggest (and as is evident throughout this issue of Perspectives), home medical equipment saw meaningful gains in key valuation indicators as median EBITDA multiples grew 9.5%, from 5.6 to 6.1X, and revenue multiples grew 10.2% from 1.47 to 1.62X. We further note that while Specialty Pharmacy and Health Care Staffing lead the pack in terms of EBITDA multiples, this is primarily due to the fact that the margins in these sectors are razor thin. Correspondingly then, when expressed as multiples of revenues, these sectors lag the others meaningfully.

Public Market EBITDA Multiples



Public Market Revenue Multiples

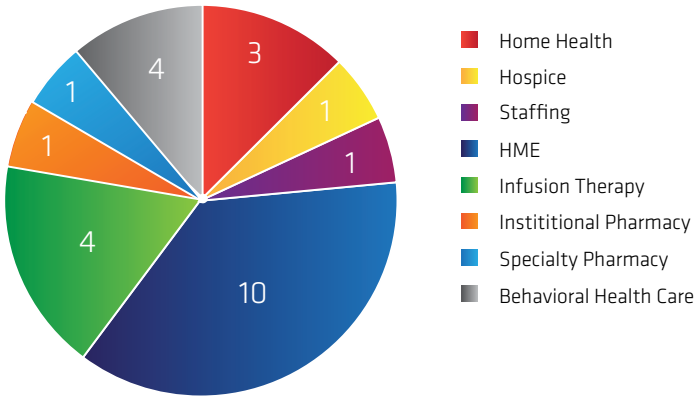


The Braff Group Index is an un-weighted index that measures the stock performance of 26 companies in seven key health care service sectors. The Composite includes all the companies in the index. The spread represents the difference between the Health Care Composite and the Broad Market Averages comprised of the Dow Jones Industrial Average, the S&P 500, and the NASDAQ 100. All stocks were indexed to 100 on February 29, 2000. Valuation indices are calculated based upon company quarterly filings. As a result of consolidation among some of the publicly traded providers, the specialty pharmacy data that informs the TBG Index and the valuation indices are drawn from one company – BioScrip. Similarly, hospice valuation data is based solely on Roto-Rooter, which owns Vitas.

* Source: The Braff Group Through 1Q 2011

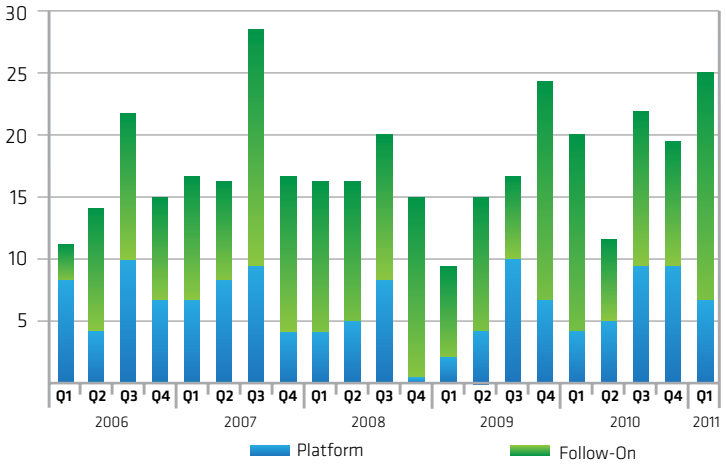
HEALTH CARE SERVICE PRIVATE EQUITY ACTIVITY

Private Equity Investment in Health Care Services



With 10 PEG sponsored transactions in the first quarter – a record for the sector – home medical equipment accounted for 40% of the 25 equity deals completed during the period. The other standout sectors were behavioral health care and infusion therapy, each accounting for four deals.

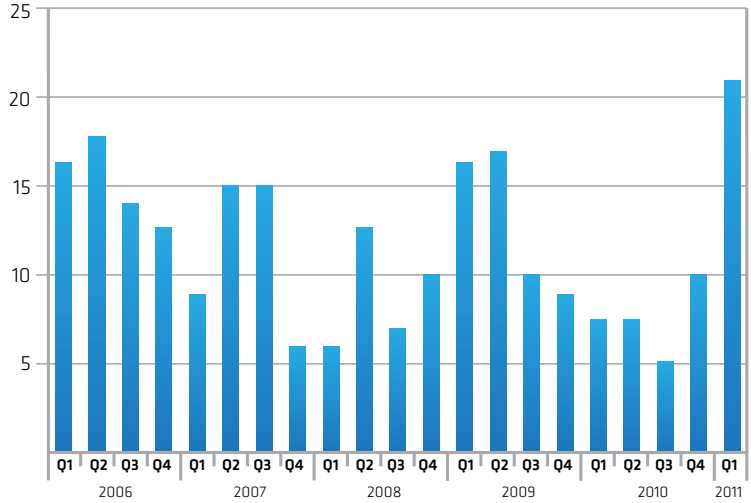
Private Equity Investment in Health Care Services



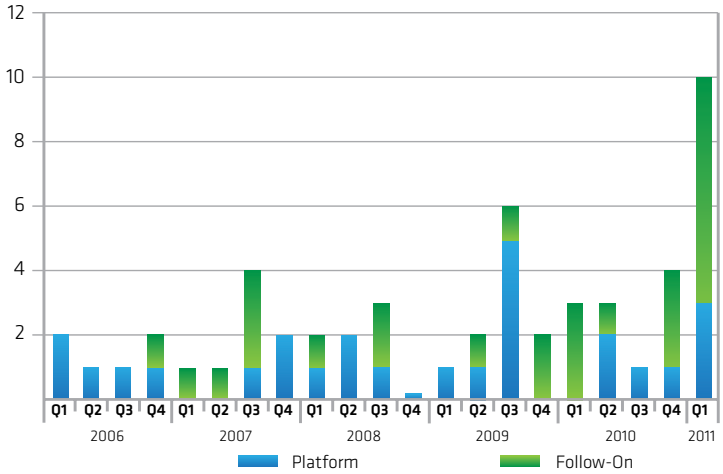
Private equity accounted for 25 transactions in the first quarter of 2011, up 32% over the prior quarter on the strength of a near-record 18 follow-on transactions. Moreover, the 30 platform deals completed over the past four quarters is just shy of the record 32 deals done over the four quarters ended June 2007 during the height of PEG activity for all industries.

SECTOR SPECIFIC PERFORMANCE: HOME MEDICAL EQUIPMENT

Home Medical Equipment Transaction Trends



Private Equity Investment in Home Medical Equipment

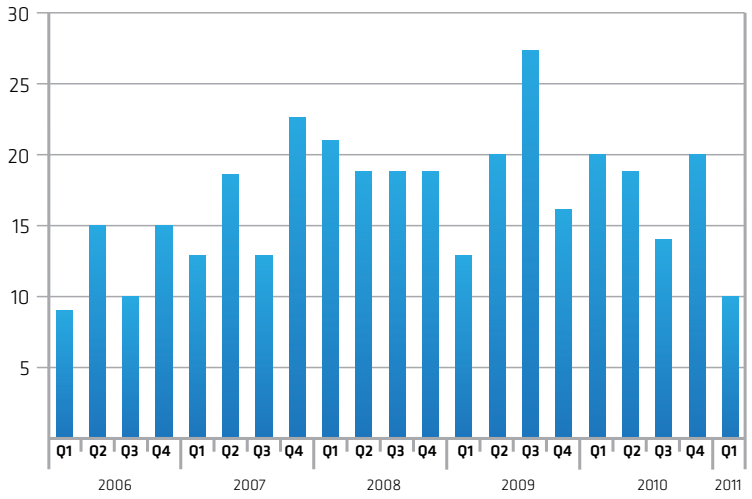


The biggest surprise of the quarter was the remarkable surge in deal flow in the HME sector, which posted 21 transactions, the largest total since the 4th quarter of 2005. The increase is due to three developments: First, as previously reported, we have seen many "opportunistic", i.e. attractively priced transactions, as sellers, who have long held on to their businesses in hope of an improved M&A climate, are reluctantly exiting. Second, with the first round of competitive bidding underway as of January 1st of this year, many non-winning bidders are targeting winning bidders in order to service non-"grandfathered" Medicare beneficiaries. Finally, we have seen an extraordinary spike in private equity activity. A close examination of these deals reveals that rather than targeting traditional DME and respiratory providers, private equity is focusing on consolidating largely overlooked segments such as rehab, mobility, sleep, and supplies, to quickly create critical mass in a market influx.

*** Source: The Braff Group Through 1Q 2011**

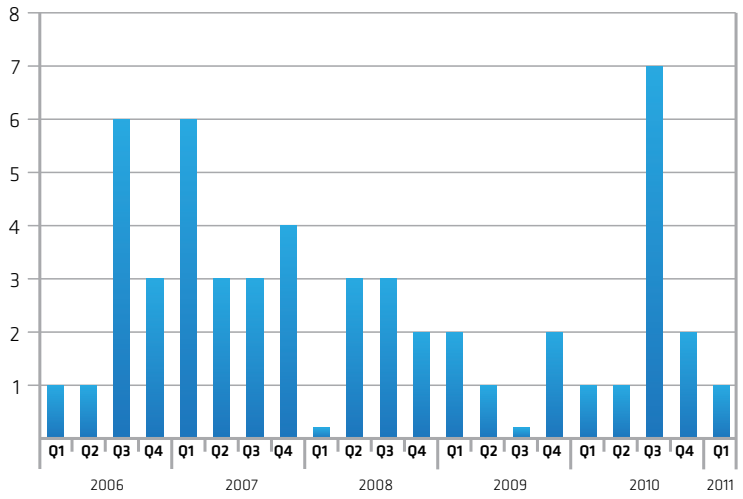
SECTOR SPECIFIC PERFORMANCE: HOME HEALTH AND HOSPICE

Medicare Certified Home Health Deal Trends



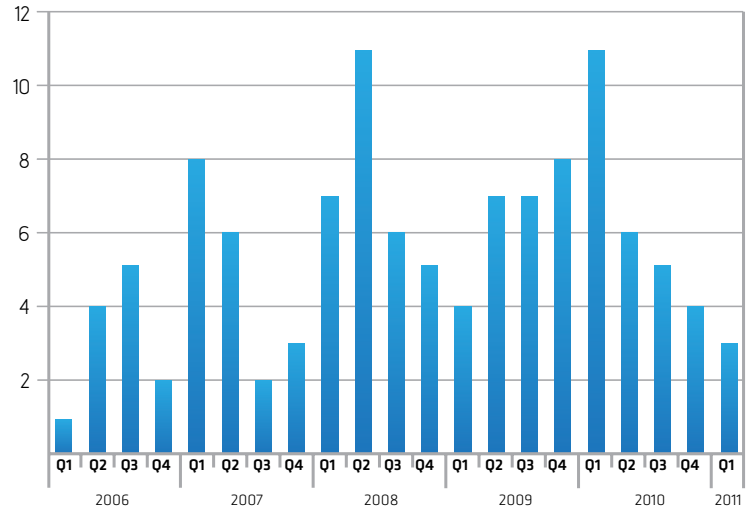
Medicare certified home health transactions plunged 50% in Q1 2011 as buyers and sellers a like turned inward to respond to 5% reimbursement cuts that became effective January 1. Additionally, with CMS and MedPAC calling for further reductions, the sector is subject to substantial risk overhang which has made buyers extremely cautious.

Medicaid Home Health Transaction Trends



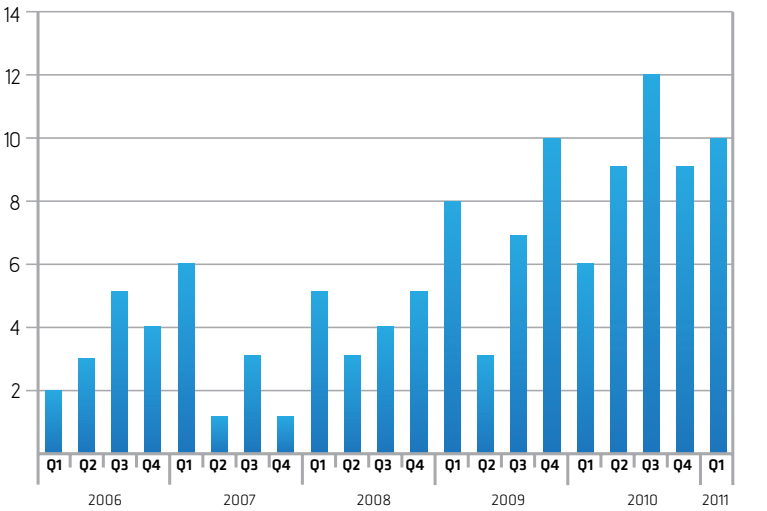
Excluding a surge in deal flow in Q3 2010, Medicaid home health has averaged one to two deals per quarter since the end of 2008. With Medicaid stimulus funds set to expire at the end of June 2011, we anticipate Medicaid M&A activity will remain limited, and opportunistic, until an improving economy generates more revenues for the states.

Private Duty Transaction Trends



Private duty transaction activity has fallen off substantially and steadily over the past four quarters. The reasons are likely two-fold: First, some of the larger private pay consolidators are still recovering from recession driven declines in utilization, tempering their acquisition appetites. Second, Medicare providers that have targeted the sector as a risk diversification play are currently out of the game, adjusting to reimbursement threats discussed above.

Hospice Transactions

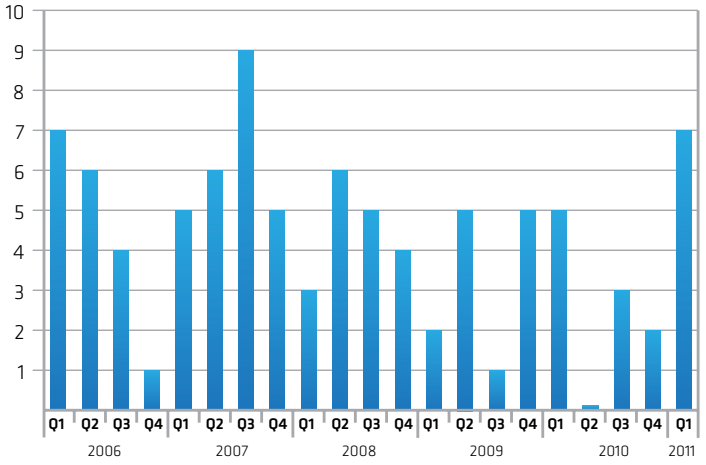


Hospice continues to roll with 10 transactions completed in the first quarter of 2011, equaling the second best quarterly tally posted in the fourth quarter of 2009. With so many favorable market conditions aligned in hospice's favor (see: MarketWatch: Hospice, Valuation, and Bubbles), we expect this trend to continue throughout 2011, unless a reimbursement change or stumble by a high-profile provider bursts the current hospice bubble.

*** Source: The Braff Group Through 1Q 2011**

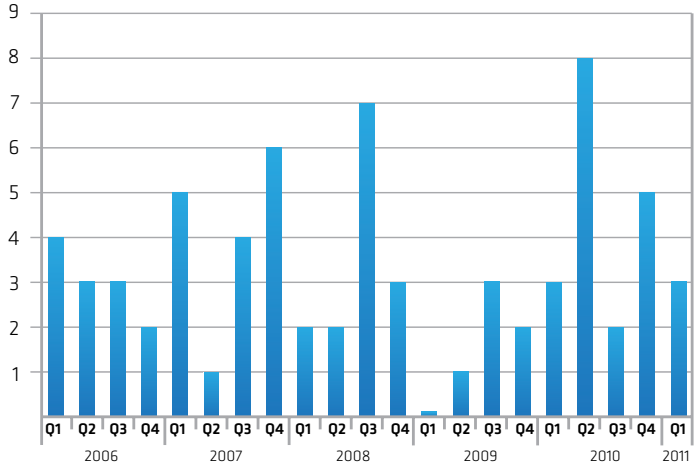
SECTOR SPECIFIC PERFORMANCE: PHARMACY SERVICES

Home Infusion Therapy Deal Trends



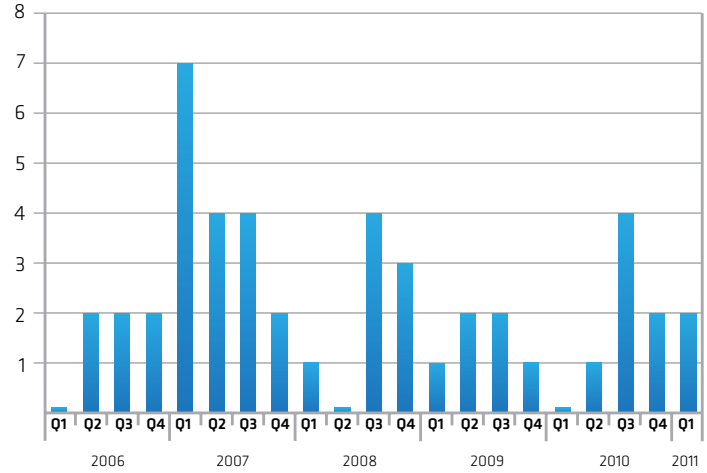
After slumping in 2010, home IV deal flow roared back in Q1 2011 with 7 transactions, with private equity accounting for 4 deals (vs. 7 for all of 2010). With activity more a function of uneven supply and demand rather than changes in the underlying economics of home IV, we expect continued up and down activity in the sector over the coming year.

Specialty Pharmacy Deal Trends



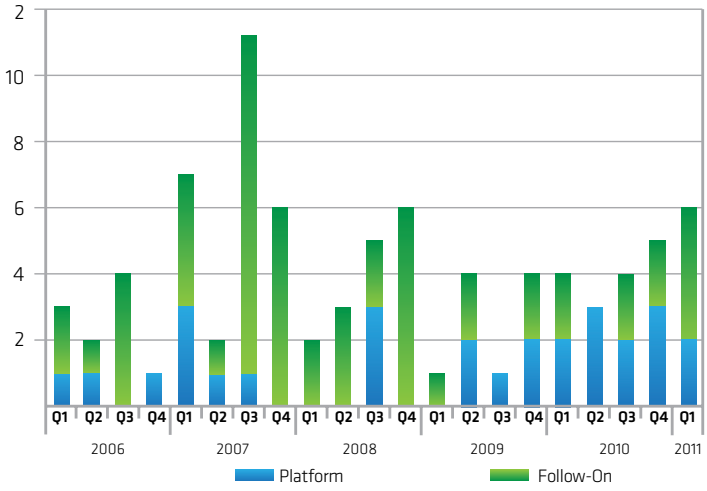
SPS got off to a fair start in 2011 with 3 deals. Most notable was the acquisition of a large SPS firm by a home medical equipment company. Long anticipated, this deal marks their – and likely other ancillary providers' interest – in leveraging their distribution and patient management capabilities into other markets and "catching the wave" of specialty RX.

Institutional Pharmacy Deal Trends



After a lackluster year in 2010, 2011 began slowly with 2 deals. Little has changed in a highly consolidated sector dominated by large players with limited remaining sizeable acquisition candidates. The next likely phase in this market? Either consolidation among the larger providers, or expansion into other markets in which they can leverage their sophisticated RX management and distribution strengths.

Private Equity Investment in Pharmacy Services (Home IV, Specialty Pharmacy, Institutional RX)

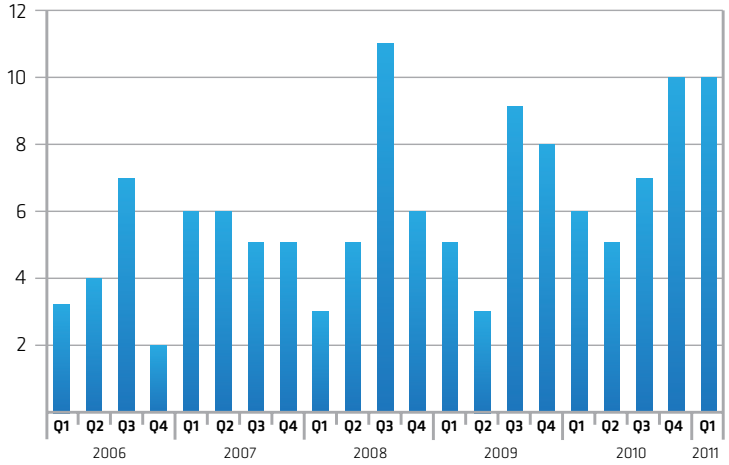


Pharmacy services continues to garner interest from private equity with 6 investments in the first quarter of 2011, the largest quarterly level since the fourth quarter of 2008. This sustained activity is due, in part, to private equity's interest in deploying more capital in larger sized transactions, particularly those – like SPS – in which margin protecting economies of scale can be realized.

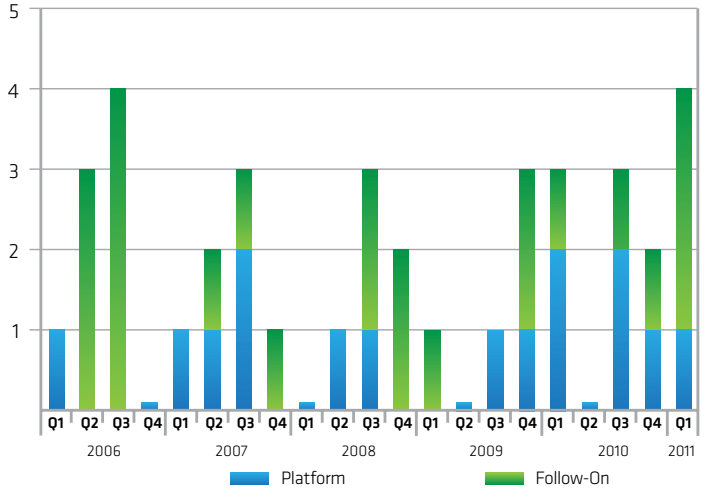
*** Source: The Braff Group Through 1Q 2011**

SECTOR SPECIFIC PERFORMANCE: BEHAVIORAL HEALTH

Behavioral Health and Social Services Deal Trends



Private Equity Investment in Behavioral Health and Social Services



Behavioral health and social services continues to shine with 10 transactions in the first quarter of 2011, equaling that of the prior quarter and just shy of the record quarterly tally of 11 deals completed in Q3 2008. Moreover, the sector posted a record-tying 4 private equity investments. Our sense is that the growth in deal activity and private equity interest is due to the fact that from a sector consolidation standpoint, compared to many other health care service segments, behavioral health and social services have been widely overlooked. Accordingly, there is substantial opportunity for strategic and financial buyers alike to stake out attractive positions in this wide-open, highly fragmented, risk moderating multi-service and payor industry.

*** Source: The Braff Group Through 1Q 2011**

VALUE DRIVING DATA

As illustrated in the pages of Perspectives, The Braff Group has compiled, by far, the most extensive database of strategic and private equity financed health care service transactions in the industry. To date, we have catalogued more than 2,000 deals that enable us to identify trends in company specific and collective buying patterns, private equity participation, acquisition supply and demand, valuation, and more. As such, our clients benefit from not only knowing where the market is today, but where it is likely headed in the future, so that they can confidently make the most informed divestiture decisions.

When it comes to who's buying, why, and for how much, no one can provide you with more accurate and timely insights...

The kind of insights that give our clients the edge necessary to drive maximum value.

THE BRAFF GROUP DIFFERENCE

The Braff Group is the leading merger and acquisition advisory firm specializing in health care services including home health care, hospice, infusion therapy, specialty pharmacy, behavioral health and social services, health care staffing, and home medical equipment.

We provide an array of transaction advisory services including sell side representation, debt and equity recapitalizations, strategic planning, and valuation. Headquartered in Pittsburgh, PA, The Braff Group has satellite offices in Atlanta, Chicago, Ft. Lauderdale, and Palm Springs.

According to Thomson Reuters, for the three years ended 2010 – The Braff Group was ranked number one in Health Care Services merger and acquisition transaction volume.

Winner, Health Care Deal of the Year, 2004, 2005, 2006, and 2009.

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