the braff group

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PERSPECTIVES

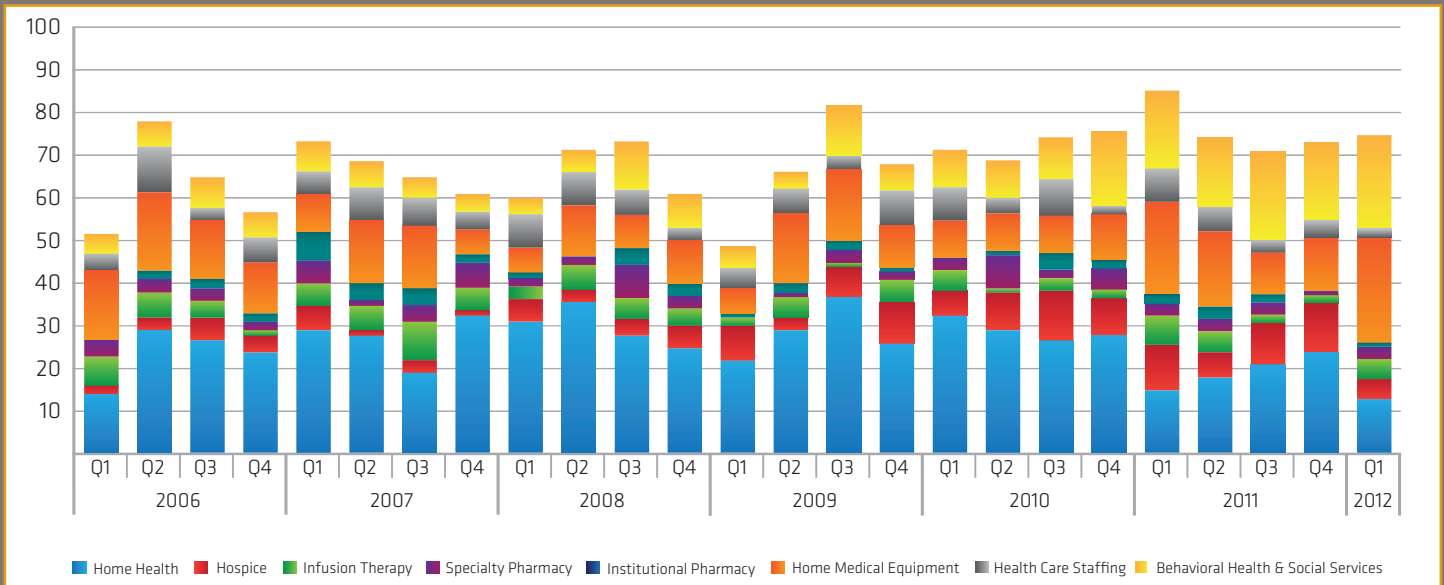
2012 FIRST QUARTER

FIRST QUARTER DEAL VOLUME UP SLIGHTLY ON SURGE IN HOME MEDICAL EQUIPMENT

Based upon proprietary merger and acquisition transaction data compiled and analyzed by The Braff Group, 2012 opened with 77 deals, up slightly over the fourth quarter of 2011, amidst a decidedly mixed bag of gains and declines. Compared to the same period last year, however, deal flow was down 10 transactions.

Notably, during the quarter, the home medical equipment sector posted a 93% spike in activity. Harkening back to the mid-2000s when HME dominated the health care service M&A landscape when the "Nationals" were in a "land grab" to capture share, home medical equipment led all sectors in transaction activity in Q1. Moreover, with 25 deals, the sector posted its largest deal volume since the third quarter of 2005, just prior to the passage of the Deficit Reduction Act of 2005 which introduced legislation that substantially derailed consolidation activity. As explained in greater detail in the following pages of Perspectives, this surge has been fueled by the entrance of private equity groups targeting specialty providers – a development that began last year, and, one that is markedly different from the last consolidation wave where the focus was narrowly limited to home oxygen providers.

Health Care Services Transactions



* Source: The Braff Group

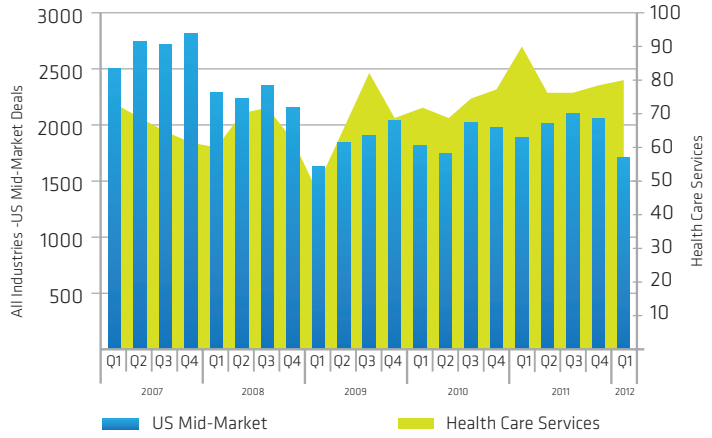
First Quarter 2012 M&A Activity

Sector	4th Qtr. 2011	1st Qtr. 2012	% Change	1st Qtr. 2011	1st Qtr. 2012	% Change
HHA-Medicare Certified	19	12	-36.8%	11	12	9.1%
HHA-Medicaid	1	-	-100%	1	-	-100%
HHA-Private Duty	4	1	-75%	3	1	-66.7%
HHA-Other	-	-	n/a	-	-	n/a
Hospice	12	5	-58.3%	11	5	-54.5%
Staffing	4	2	-50%	8	2	-75%
HME	13	25	92.3%	22	25	13.6%
Infusion Therapy	2	5	150%	7	5	-28.6%
Institutional Pharmacy	-	1	n/a	2	1	-50%
Specialty Pharmacy	1	3	200%	3	3	0.0%
Behavioral Health	19	23	21.1%	19	23	21.1%
Total	**75**	**77**	**2.7%**	**87**	**77**	**-11.5%**

The gains in the home medical equipment sector were more than offset by substantial declines in home health and hospice. In aggregate, home health and hospice accounted for 18 transactions in Q1 2012, down 18 deals, or 50%, from the 36 deals completed in Q4 2011, and down eight deals, or 30.7%, from the 26 deals completed over the same period last year. We've noted in past editions of Perspectives that home health care, particularly Medicare certified home health, has been plagued by reduced reimbursement and intense regulatory scrutiny, driving up the segments' risk profile and slowing buyers' acquisition plans. As for hospice, even after another record breaking year of transaction activity in 2011, we've noted signs of softness encroaching on the market and have written extensively about it (see MarketWatch: Will 2012 Mark the End of Peak Pricing for Hospice?). It is too early to tell if Q1 is just a temporary "blip" in the sector, or a harbinger of decreased demand as buyers become increasingly wary of, among other things, payment reform initiatives and increased regulatory oversight. Accordingly, we will be monitoring this sector closely throughout the year.

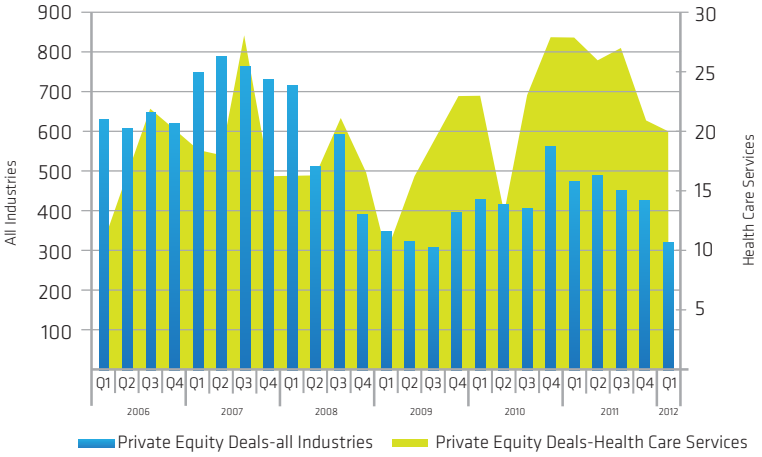
While home medical equipment and home health and hospice effectively "bookended" M&A activity during the quarter, there were other bright spots in between. In aggregate, pharmacy services (infusion therapy, specialty pharmacy, and institutional pharmacy) accounted for nine transactions, up 200% over the fourth quarter of 2011, and the largest tally since the second quarter of 2011. Additionally, behavioral health and social services – the breakout sector in 2011 – had another strong quarter with a record breaking total of 23 deals, up 21% over Q4 2011.

US Middle Markets vs. Health Care Service Deal Trends



While health care service transaction volume ticked upwards 2% in Q1 2012, overall middle market M&A activity fell 15.8% – from 2,022 deals in Q4 to 1,702 in Q1 – the lowest level since Q1 of 2009 when the market bottomed out as the economy tumbled and credit froze. While a sluggish recovery continues to dog middle-market activity, we haven't seen the kind of dramatic change in market conditions or access to credit that would explain such a retreat. Accordingly, our sense is that this noteworthy fall is likely more of an anomaly than a trend. We'll see.

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



Since the fourth quarter of 2009, we have seen a relatively steady decline in private equity investments across all industries, as well as health care services. The big difference, though, is that despite the steady decline, PE investments in health care services nevertheless hit an all time high in 2011 as the decline in health care occurred after record breaking quarterly PE deal flow, and the fall off in health care has been less severe than that for all industries (28.6% vs. 42.8%).

*** Source: Pitchbook Platform; The Braff Group**

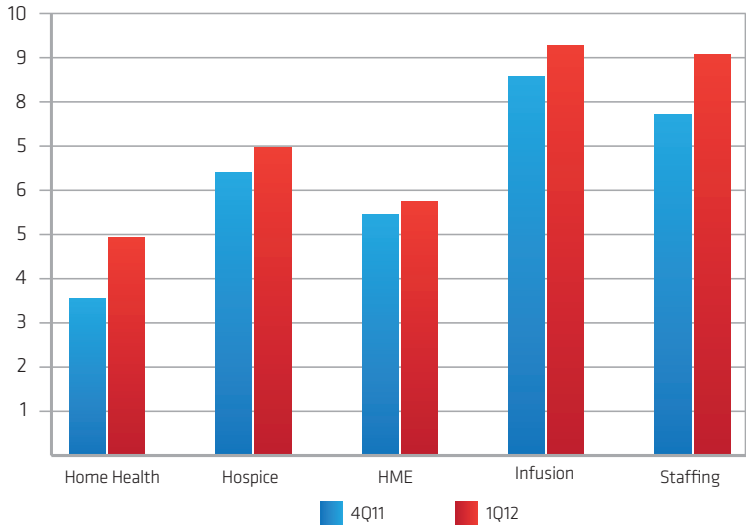
THE PUBLIC MARKETS

The Braff Group Index

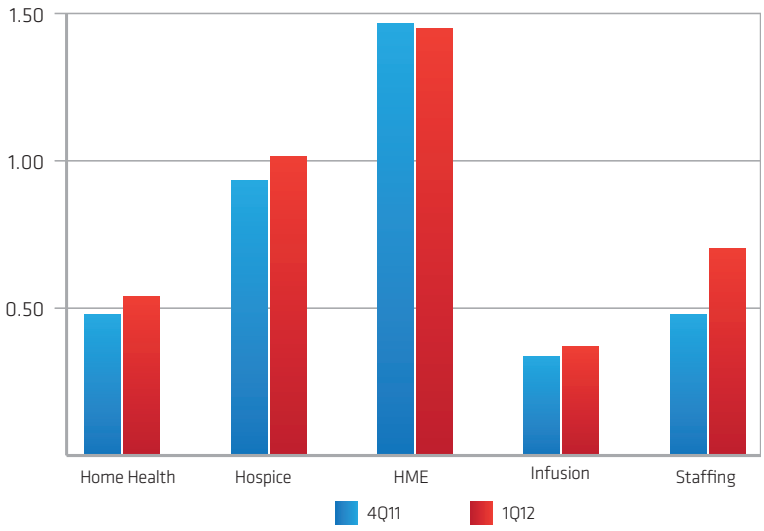
Period	Broad Market Average	HME	HHA & Hospice	IV	Health Care Staffing	Hospitals	Long Term Care	eHealth	TBG Composite	Spread
Q409	77.6	122.0	1018.9	170.5	52.4	204.7	291.0	116.3	359.2	281.6
Q110	81.3	150.5	1017.2	163.0	52.2	225.1	307.3	118.2	365.0	283.8
Q210	72.3	193.5	934.8	106.9	41.7	215.2	267.5	105.3	335.8	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
Q211	92.8	209.1	723.1	132.4	55.7	248.7	469.0	169.3	325.9	233.1
Q311	80.7	148.9	412.8	129.7	35.1	184.0	283.7	174.4	214.9	134.3
Q411	89.4	161.1	375.5	111.4	50.5	198.5	360.5	162.2	215.2	125.8
Q112	99.8	163.2	550.9	138.5	70.1	214.7	397.9	195.6	274.1	174.3
Change	**11.6%**	**1.3%**	**46.7%**	**24.4%**	**39.0%**	**8.1%**	**10.4%**	**20.6%**	**27.4%**	**38.5%**

For the first time in a long time, it was good news across the board for the health care service segments that comprise The Braff Group Public Market Index, with every sector posting gains in the first quarter of 2012, propelling the TBG Composite Index to its highest level since the second quarter of 2011. Moreover, the median public market valuation benchmarks for home health care, hospice, home medical equipment, infusion, and health care staffing rose nearly universally, with only the revenue multiples for ***HME*** essentially holding steady with an inconsequential drop of .01. The big gainer during the period was the much beleaguered ***home health and hospice*** segment, which plunged nearly 60% in 2011 on a litany of bad news regarding reimbursement and regulatory scrutiny. In Q1 2012, however, the sector surged 46% on a combination of better than expected quarterly results for several providers as well as news that the President's budget proposal did not include any further cuts to home health or hospice, and, did not include co-pays (despite calling for $360 million of other Medicare spending reductions over 10 years). Also notable, during the quarter, was the 39% surge in the ***health care staffing*** index, which closed at its highest quarterly level since the third quarter of 2008, perhaps signaling that the long slide the industry succumbed to as demand waned in the face of high unemployment, has been arrested. Finally, ***infusion therapy*** spiked 24% on BioScrip's decision to divest its specialty Rx business to Walgreens as well as better than anticipated fourth quarter performance.

Market Value of Invested Capital / EBITDA



Market Value of Invested Capital / Revenue

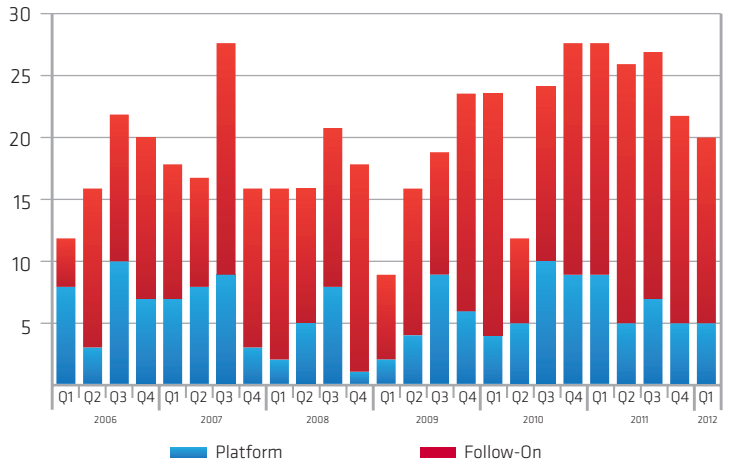


The Braff Group Index is an un-weighted index that measures the stock performance of 26 companies in seven key health care service sectors. The Composite includes all the companies in the index. The spread represents the difference between the Health Care Composite and the Broad Market Averages comprised 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 infusion therapy 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

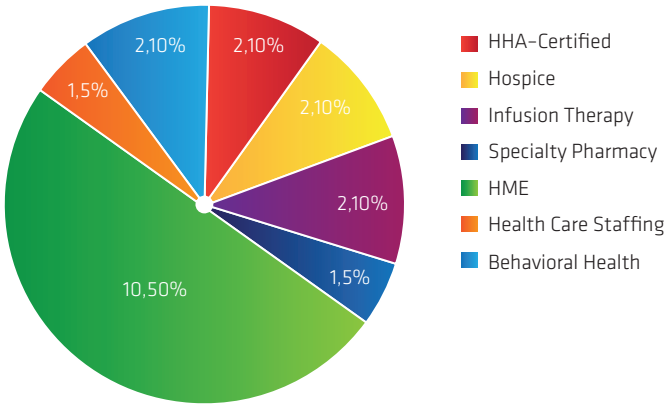
HEALTH CARE SERVICE PRIVATE EQUITY ACTIVITY

Private Equity Investment in Health Care Services



After four consecutive quarters of near record breaking private equity investments in health care services, PE volume fell 22.2% in Q4 2012, followed by another decline of 4.8% in Q1 2012. After two quarters, this may be an emerging trend as investors react to the cumulative effects of, among other things, health care reform and budget deficit driven threats to reimbursement.

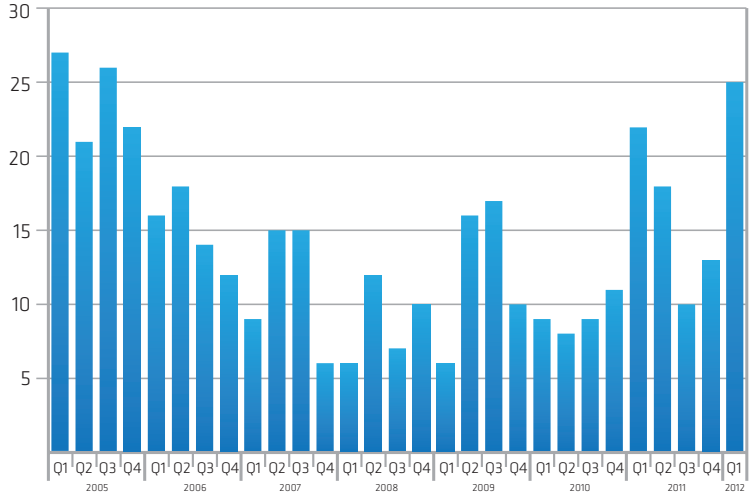
Private Equity Investment by Service Segment



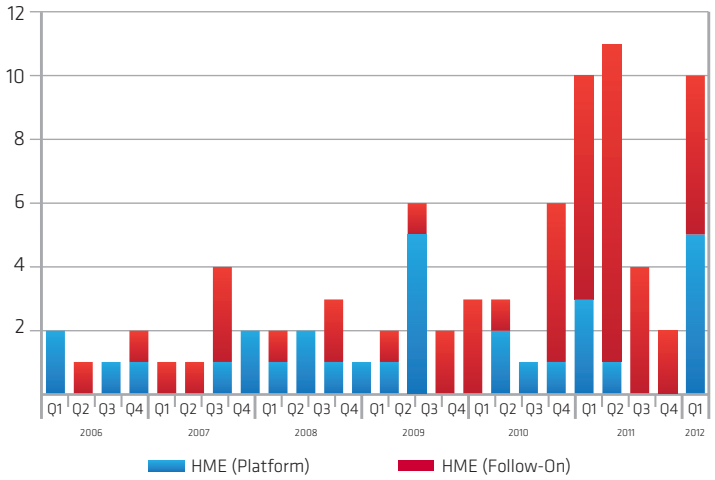
In 2011, home medical equipment drew the largest proportion of private equity investments (26%), followed closely behind by behavioral health and social services (22%). In Q1 2012, HME continued drawing outsized interest, accounting for 50% of investments, far outpacing all other segments. See Sector Specific Focus: Home Medical Equipment for further details.

SECTOR SPECIFIC PERFORMANCE: HOME MEDICAL EQUIPMENT

Home Medical Equipment Transaction Trends



Private Equity Investment in Home Medical Equipment

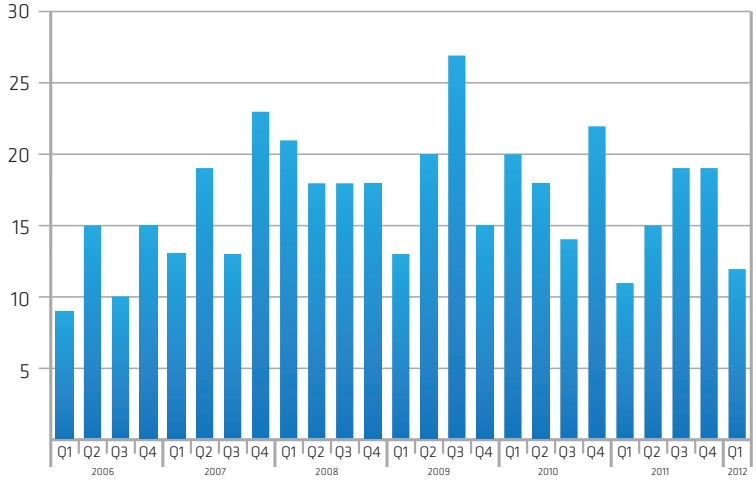


In our fourth quarter 2011 issue of Perspectives, we opined that the substantial fall-off in deal volume in the second half of 2011 was largely attributable to an equally sharp fall-off in private equity investment activity. We further surmised that after an extremely busy first six months of the year, "the second half plunge may be short-lived, as investors digest their 2011 deals and free up financial and operating resources to seek out new acquisition candidates." This turned out to be particularly prophetic as investment activity roared back in the first quarter of 2012 with 10 transactions, including a record tying five new platform investments. This, in turn, fueled a surge in overall transaction volume to 25 deals in Q1, the largest number since Q3 2005. Dominating the deal flow were transactions in medical supplies, mobility, and sleep products and services as buyers continue to seek out critical mass and competitive advantages in niche segments of the home medical equipment industry.

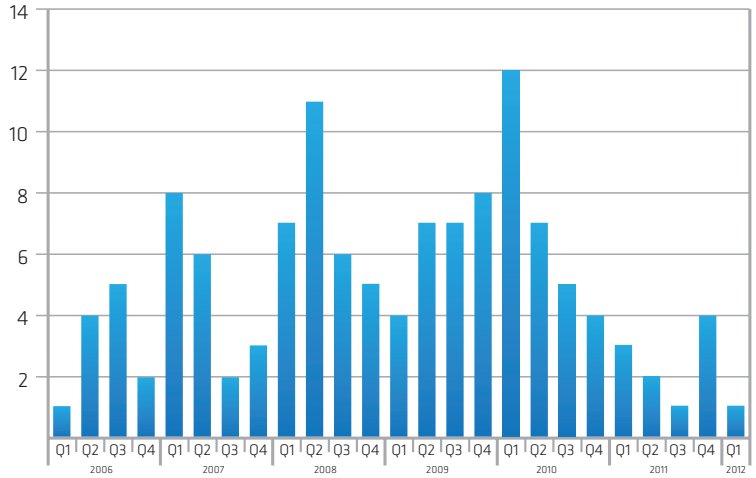
*** Source: The Braff Group**

SECTOR SPECIFIC PERFORMANCE: HOME HEALTH AND HOSPICE

Medicare Certified Home Health Deal Trends

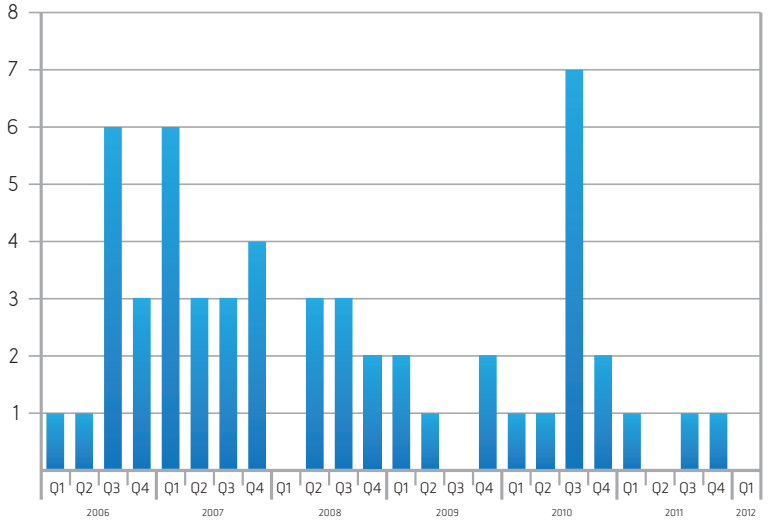


Private Duty Deal Trends

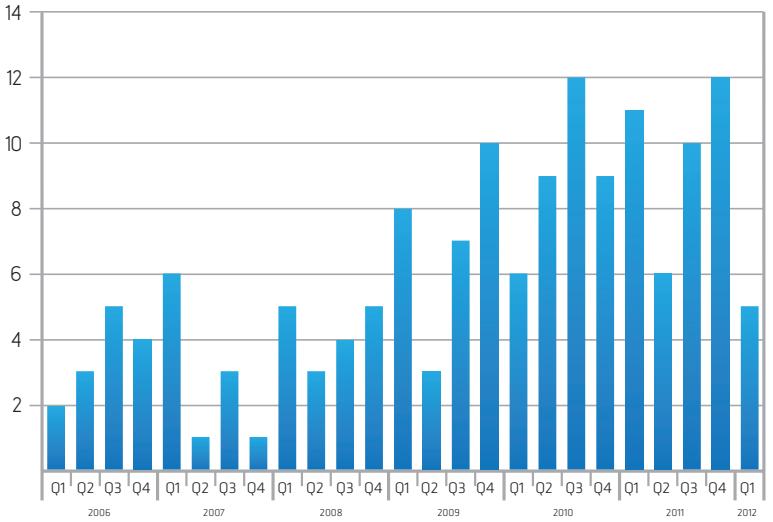


It was a brutal quarter for home health and hospice M&A activity. On the home health side, if we aggregate Medicare certified, Medicaid, and private pay home health, the 13 combined transactions were the lowest tally since the second quarter of 2004. After showing some modest gains over the past three quarters, ***Medicare certified*** deal flow fell sharply in Q1 2012, down 36.8% from 19 to 12 transactions. From our extensive conversations with industry owners, executives, and other "insiders," it is clear that buyers continue to struggle with both cuts ***and*** revisions to the prospective payment system, and fear, among other areas, that Congress will re-open budget deficit reduction measures in lieu of up to 2% cuts in reimbursement mandated via "sequestration." This could, once again, expose the sector to even greater cuts and/or co-pays that could be far more destructive and disruptive. After a nice bump in activity last quarter, ***private duty,*** once again, fell to a single transaction. And, in ***Medicaid home health***, Q1 marked the second time over the past 12 months that the sector didn't notch a single transaction. It wasn't much better for ***hospice,*** the sector that has posted four consecutive years of record breaking activity. With five deals in Q1, hospice posted its lowest quarterly total since Q2 2009. If we see a repeat of this lackluster activity in Q2, it may signal that the sector has moved off its M&A peak, as fear of payment reform, increased regulatory scrutiny, and satiation of acquisition demand has chipped away at the sector's foothold atop health care service M&A.

Medicaid Home Health Deal Trends



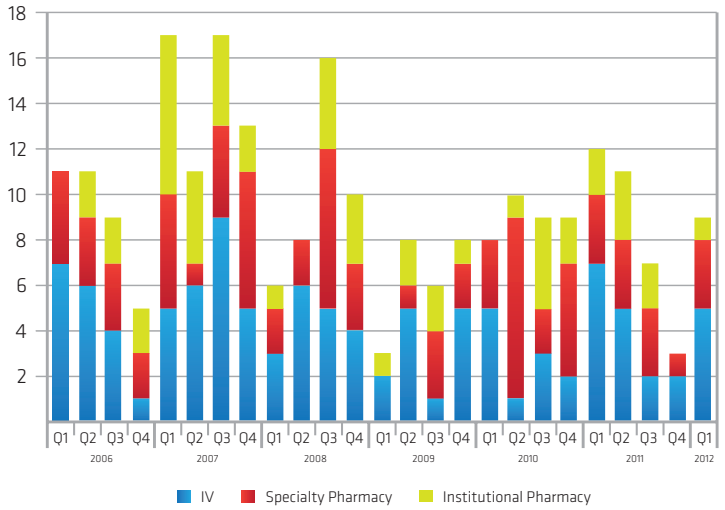
Hospice Deal Trends



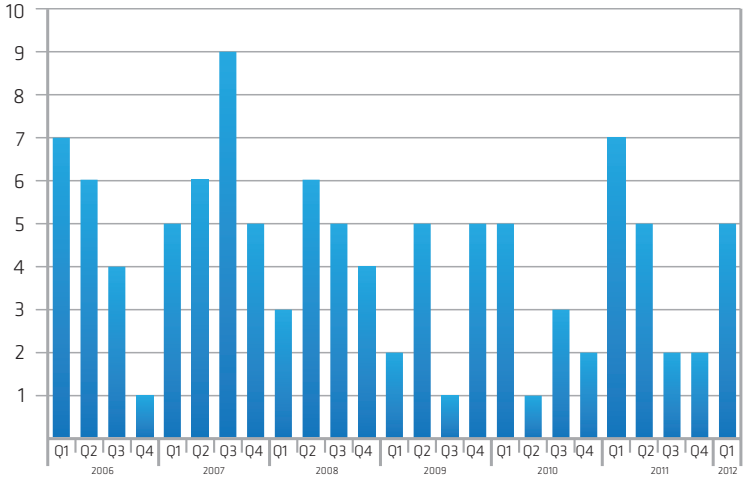
* Source: The Braff Group

SECTOR SPECIFIC PERFORMANCE: PHARMACY SERVICES

Pharmacy Service Deal Trends

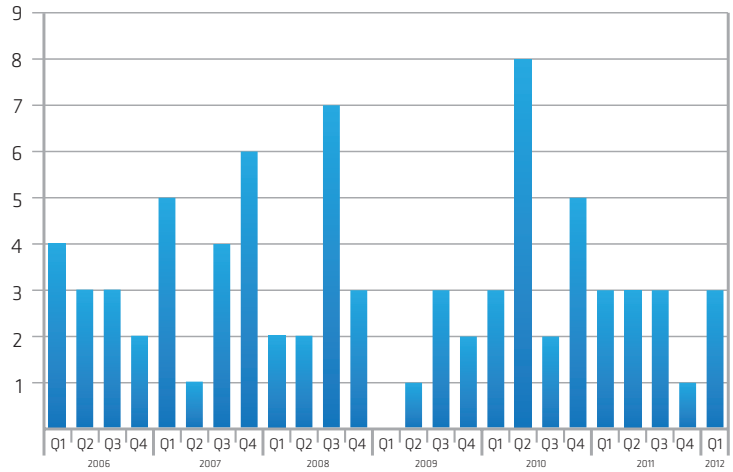


Infusion Therapy Deal Trends

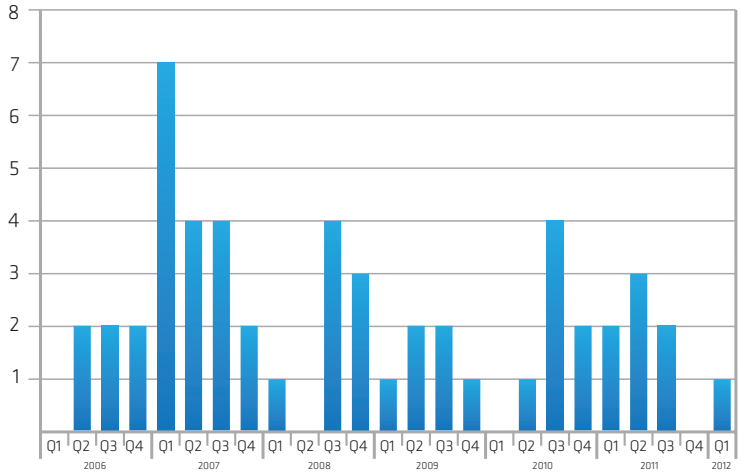


After a particularly dismal performance last quarter, aggregate pharmacy service M&A activity bounced back strongly in Q1 2012, largely on the strength of ***home infusion therapy***, which posted five deals, up from only two last quarter. In our last issue of Perspectives, we noted that the buyer pool interested in home IV was becoming increasingly more diversified. This development was very much in evidence once again in Q1 as the five deals were completed by five different buyers. Also noteworthy, during the quarter, was that BioScrip, a specialty pharmacy provider that had previously acquired IV consolidator Critical Homecare Solutions to diversify its pharmacy services holdings, announced its plan in Q1 to divest its core specialty business to Walgreens, ***preferring instead, to focus exclusively on IV.*** In ***specialty pharmacy***, for the fourth time in the past five quarters, the sector posted three transactions. And, in ***institutional pharmacy***, after a brief absence, the sector got back on the board in Q1, albeit with one deal. We expect more from this sector over the coming year as there were four new private equity sponsored investments in institutional Rx in 2011, which will undoubtedly lead to additional follow-on transactions. Regarding private equity activity, one final observation of note: While there were three follow-on deals in pharmacy services, during the quarter, there wasn't a single new platform investment made during the period – the first time this has occurred since the first quarter of 2009. While this is likely an anomaly, we will be watching this carefully to see if there has been a shift in investor sentiment toward pharmacy services.

Specialty Pharmacy Deal Trends



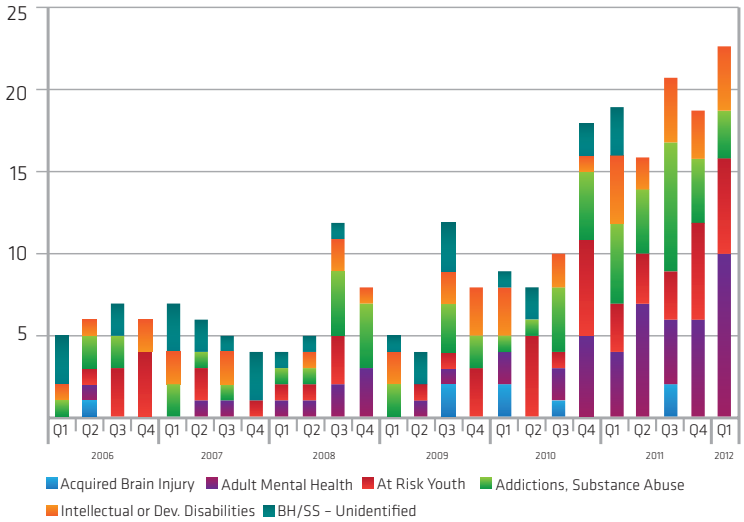
Institutional Pharmacy Deal TrendsServices



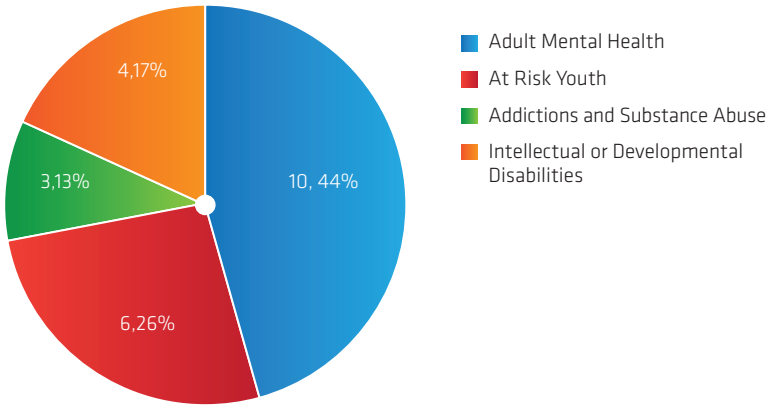
* Source: The Braff Group

SECTOR SPECIFIC PERFORMANCE: BEHAVIORAL HEALTH

Behavioral Health Care and Social Services Deal Trends



Behavioral Health Care and Social Services Deals by Segment



After a "breakout" year in 2011, ***behavioral health and social services*** continued to shine with 23 transactions, the fourth time in the past six quarters that the sector has posted record breaking transaction activity. It was a particularly strong quarter for providers of ***adult mental health,*** which contributed a record 10 transactions, accounting for 44% of all BH/SS transactions and supplanting, at least temporarily, ***addictions and substance abuse*** as the leader in deal flow (ASA transactions led all other behavioral health and social service segments in transaction activity in 2011, accounting for 28% of M&A activity). Equally as noteworthy was the fact that of the 23 deals, nine involved the merger of two not-for-profit providers. In reviewing our extensive database of transaction activity over the past year or so, it would appear that of all the healthcare service sectors we cover, that have many not-for-profit providers – behavioral health and social services, Medicare home health, and hospice – we see far more not-for-profit mergers in BH/SS. Two observations: First, while we are ***not*** opining on the reasons behind any of these mergers, we do note that as a result of the prolonged economic slump and the challenges not-for-profits, in general, are having mustering community resources and fundraising dollars, an increasing number of NFPs are merging to capture operating synergies in order to remain viable. Second: given the comparatively high cost of many behavioral health and social services programs, and given that many are reliant on Medicaid and other state funding which, in many cases has been severely curtailed, BH/SS NFPs ***may*** be comparatively more exposed to financial pressure than largely Medicare reimbursed home health and hospice.

*** Source: The Braff Group**

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 capture 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.

Chuck Gaetano	Reg Blackburn	Ted Jordan	Mark A. Kulik	Nancy Weisling	Pat Clifford	Bob Leonard	Steven Braff
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