the braff group

perspectives

3rd Quarter 2007

A health care merger & acquisition quarterly

M&A Quarterly Update

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Third Quarter Transaction Volume Falls 7.4%

Infusion Therapy Sector Surpasses 2006

Based on preliminary results for the third quarter, merger and acquisition transaction volume in the home health, hospice, infusion therapy, specialty pharmacy, home medical equipment and health care staffing sectors fell 7.4% from last quarter and 10.7% vs. the same quarter last year. For the nine months ended September 30, total deal flow is down 10.5%, from 171 deals in 2006 to 153 deals in 2007.

The largest fall-off during the quarter came from the **home health sector** with 18 deals announced and/or completed, down 28% from 25 deals in Q2. Year-to-date, however, transaction activity is dead-even with 2006, with 68 deals completed through nine months.

The looming question is whether or not the decline is attributable to concerns regarding revisions to the prospective payment system (PPS), or is rather a temporary blip in activity in an otherwise highly attractive market. Based on numerous and continued discussions The Braff Group is having with buyers, while they are certainly evaluating the potential impacts of PPS reform, **these reforms have not dampened their interest in the home health sector — nor have they negatively impacted valuation**.

In fact, the quarter was marked by several high profile transactions: **Amedisys' (NASDAQ:AMED)** acquisition of **IntegriCare**, a $60M multi-state provider; private equity group **Flexpoint Partners'** entry into the home health arena with their acquisition of **Texas Health Care Management —** a Braff Group transaction, and perhaps most noteworthy, **Thoma Cressey Bravo's** acquisition of **Encompass Home Health**, a $120 million home health portfolio company of private equity firm **Apax Partners**.

It is quite possible then that the third quarter fall-off is attributable to a delay in completing transactions as buyers analyzed the impact of the final rule (disclosed mid-quarter) and the unexpected increase of the "creep" reimbursement cut from 8.25% over three years to (continued page 3, column 2)

Third Quarter 2007 M&A Activity

Broad Industry	2nd Qtr. 2007	3rd Qtr. 2007	% Change	3rd Qtr. 2006	3rd Qtr. 2007	% Change	YTD 2006	YTD 2007	% Change
HHA	25	18	-28.0%	27	18	-33.3%	68	68	0.0%
Hospice	-	3	n/a	5	3	-40.0%	10	9	-10.0%
Staffing	7	6	-14.3%	3	6	100.0%	18	18	0.0%
HME	14	13	-7.1%	13	13	0.0%	46	33	-28.3%
Infusion Therapy	7	8	14.3%	4	8	100.0%	17	20	17.6%
Specialty Pharmacy	1	2	100.0%	4	2	-50.0%	12	5	-58.3%
Total	**54**	**50**	**-7.4%**	**56**	**50**	**-10.7%**	**171**	**153**	**-10.5%**

Prior period data is updated as new information becomes available, accordingly chart may differ from previous editions of *Perspectives*. Excludes deals where quarter is unknown.

Industry Spotlight: The Credit Crunch and Private Equity

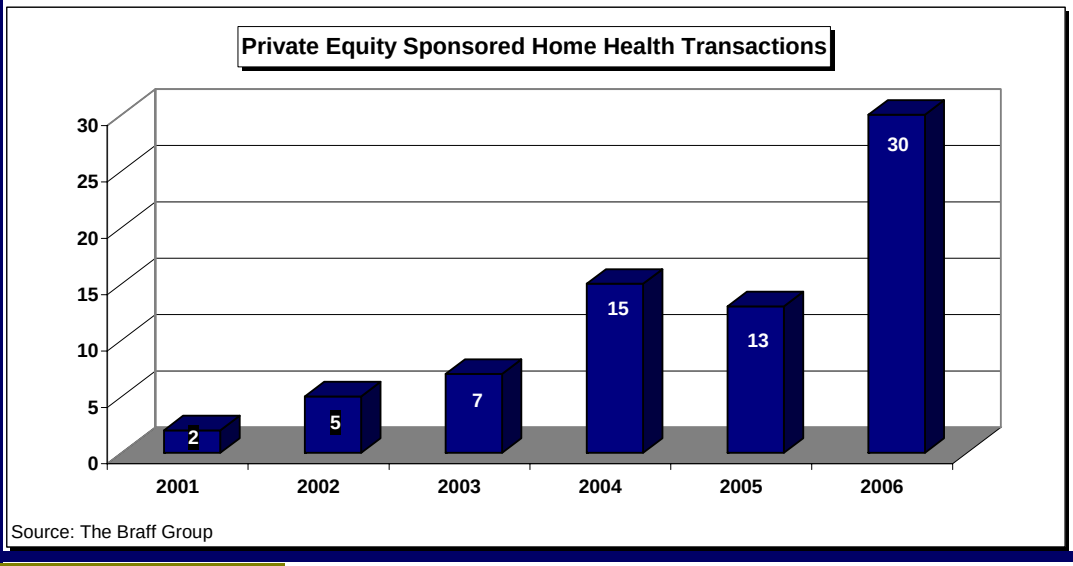
"Unlike many private equity sponsored transactions that have fueled the M&A boom that have relied heavily on debt for financing — notably in the real-estate heavy skilled nursing arena — we have seen PEGs ante up substantially more equity to complete home care related deals"

Pick-up the business section of any newspaper today and you're almost guaranteed to see a story about the growing "credit-crunch". With the current practice of debt being originated, repackaged into various types of mortgage backed securities and collateralized debt obligations, which are in-turn sold – and resold – to the investment community, rising defaults in the sub-prime mortgage markets have rippled throughout Wall Street, not only taking out some major players including some well-heeled hedge funds, but creating a crisis of confidence that likely exceeds the real risk exposure. As a result, availability of new debt – including acquisition financing – is tightening, the cost is rising, and loan covenants designed to protect lenders are getting tighter. Moreover, private equity groups (PEGs), which have contributed mightily to the record setting boom in acquisition activity, may find it more difficult to finance these deals.

So how will this affect merger and acquisition activity in the broad home care arena?

First and foremost, we should point out that private equity has, in part, fueled the five year surge in home care related acquisition activity – first in hospice (2003-2006), then home health (2002 – present), and most recently, home infusion therapy (2006-present). As one example, according to Braff Group research, while there were 14 private equity sponsored home health acquisitions from 2001 through 2003, there were 28 such deals from 2004 through 2005, and 30 in 2006 alone (see graph below). With private equity playing such a critical role in the home care community, any hindrance on their ability to finance a transaction and/or generate sufficient returns could meaningfully constrain acquisition demand and valuation.

The good news, however, is that generally speaking, with businesses that are light on assets and largely dependent on third party reimbursement, except perhaps for transactions in the $100 million range (which make up a fraction of industry deal flow), lenders have been far more conservative and disciplined with respect to financing acquisitions of health care service providers such as home health, hospice, and infusion than they have for more asset laden firms with less perceived risk. As such, unlike many private equity sponsored transactions that have fueled the M&A boom that have relied heavily on debt for financing — notably in the real-estate heavy skilled nursing arena — we have seen PEGs ante up substantially more equity to complete home care related deals. With PEGs targeting the home care space more accustomed to (a) less favorable debt availability, price, and terms, and (b) deploying more equity to close transactions, our view is that whatever negative impact the growing credit crunch will



Source: The Braff Group

have on merger and acquisition activity in general, the impact will be far less problematic in the home health, hospice, and infusion therapy arena. Moreover, post-transaction, with less debt on the books, many PEG sponsored home health companies will be better able to weather potential reductions in reimbursement which, in turn, will foster market stability that is critical in sustaining a long run of M&A activity.

Unfortunately, something else besides the credit crunch looms ominously – a development that could significantly challenge private equity and all the investments it targets. In the wake of an M&A environment that has swelled the coffers of many PEGs and has bestowed riches and celebrity to its key players, Congress has begun to scrutinize how private equity groups and hedge funds are taxed. Simply put, the bulk of the fees these firms receive are based on a percent of the profits generated by the funds they manage – profit that largely comes from the buy-out and subsequent resale of companies in their "portfolio". Conceptually then, the appreciation on these investments is capital gains, and has been taxed accordingly at 15%, far below the top end of the tax on earned income – 35% – to encourage investment. But critics argue that these profits are being earned largely on investments of *other people's money* such as wealthy individuals and pension funds – and not that of the PEGs themselves. As such, fees derived from them are arguably more akin to money management fees, which would be taxed at the higher earned income rate. Regardless of how you feel about the efficacy of this argument, if PEGs lose their capital gains tax treatment and take a hit to their profitability, we would anticipate changes in their behavior – changes we fear might curb their voracious acquisition appetites that have collectively spiked demand and valuation across many business sectors, including home care.

Third Quarter M&A Update
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10.96% over four years. If this is the case, we may see a surge in activity in the fourth quarter as delayed third quarter transactions come to a close.

Looking further into the near future, we anticipate the possibility of another spike of acquisition activity in home health in the second quarter of 2008 when speculation gives way to hard data and the reimbursement impact of PPS reform — good and bad — is fully realized by both buyers and sellers alike.

In a related space, we also note that the hospice sector, which, from an M&A perspective was blanked in the second quarter, rebounded nicely with three deals in Q3.

While home health slowed down, the **infusion therapy** sector continued to surge with eight deals in the third quarter, one up from last quarter and double the volume posted during the same period last year. More importantly, by the end of the third quarter, with 20 deals year-to-date, the sector has already surpassed the record transaction volume recorded in all of 2006 (19). Particularly noteworthy was **Walgreen's (NASDAQ:WAG)** acquisition of **Option Care** at a valuation estimated by Lehman Brothers at approximately 1.2 x trailing twelve month revenues and 19.4 x trailing twelve months EBITDA (earnings before interest, taxes, depreciation, and amortization). Additionally we note dialysis provider **DaVita's (NASDAQ:DVA)** acquisition of **HomeChoice Partners** for $65M, which, based on the DaVita's press release, equates to 1.76 times Home Choice Partners' trailing twelve month revenues.

When we add in early fourth quarter announcements of **Apria's (NYSE:AHG)** intentions to acquire **Coram**, and **Kohlberg & Company**
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The Braff Group is a leading middle market merger and acquisition firm that specializes in the home health care, hospice, infusion therapy, specialty pharmacy, home medical equipment, medical device, pharma, and staffing market sectors. We provide merger and acquisition representation, strategic planning, and valuation services.

The Braff Group Index

	Broad Market Average	HME	HHA & Hospice	Specialty RX & IV	Health Care Staffing	Hospitals	Long Term Care	eHealth	TBG Compos-ite	Spread
Q4 06	92.8	197.4	682.4	94.6	141.6	211.9	630.0	94.1	313.2	220.4
Q1 07	92.5	254.2	727.5	82.9	130.9	216.3	720.4	94.5	337.5	245.0
Q2 07	99.3	233.0	668.9	102.5	121.9	230.8	670.5	94.7	320.2	221.0
Q3 07	102.1	173.7	635.5	146.5	107.2	183.8	622.2	98.3	301.0	198.9
Change	**2.9%**	**-25.4%**	**-5.0%**	**43.0%**	**-12.0**	**-20.3%**	**-7.2%**	**3.7%**	**-6.0%**	**-10.0%**

It was a tough quarter for the health care service sectors we cover as the TBG Composite Index fell 6% with five of the seven sectors we track posting meaningful declines. The home medical equipment sector lead decliners with a 25.4% plunge as the market reacted to SCHIP bills that included substantial reductions to oxygen reimbursement caps. On a more positive note, the Specialty Rx and Infusion therapy sector surged 43% on increased investor enthusiasm in the space as the quarter opened with Walgreen's (NASDAQ:WAG) acquisition of Option Care. We should also point out that at 102.2, our Broad Market Index eclipsed the original index price of 100 set on February 29, 2000 for only the fourth time in nearly 8 years.

The Braff Group Index measures the stock performance of 34 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. All stocks were indexed to 100 on February 29, 2000.

Q3 Public Company Performance and Valuation Benchmarks

Sector	HME	HHA	Hospice[1]	Staffing	Specialty RX & IV[1]	Composite
Mean EBITDA %	**20.5%**	**11.8%**	**8.4%**	**5.6%**	**2.4%**	**10.7%**
Median EBITDA %	**18.8%**	**11.3%**		**6.1%**		**9.2%**
Mean MVIC : Revenues[2]	**1.27**	**0.98**	**0.49**	**0.60**	**0.32**	**0.81**
Median MVIC: Revenues	**0.94**	**0.86**		**0.56**		**0.75**
Mean MVIC : EBITDA[2]	**6.00**	**8.03**	**7.53**	**12.58**	**15.21**	**9.71**
Median MVIC: EBITDA	**5.96**	**8.10**		**14.20**		**8.25**

Public Company Performance and Valuation Benchmarks are based on 18 publicly traded companies. MVIC equals Market Value of Invested Capital (total shares outstanding x stock price less cash plus non-working capital interest bearing debt). [1]Two firms included in the sector, therefore mean and median calculations are the same. [2]Figures reflect valuation ratios.

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backed **Critical Homecare Solutions**' filing for an initial public offering, it is clear that the merger and acquisition market for infusion therapy companies is as vibrant as the "glory years" of the early 90s. Perhaps more importantly, the acquisition interest is coming from multiple directions — existing strategic players, ancillary service providers, and private equity — an extremely attractive market characteristic that we speculate should sustain acquisition demand over at least the next 12 to 18 months.

Finally, we would be remiss if we didn't mention three other transactions of merit — **Medco Health Solutions' (NYSE: MHS)** blockbuster acquisition of diabetes and specialty pharmacy supply provider **Polymedica (NASDAQ:PLMD)**; **HIG Capital** backed **Harvard Drug Group's** acquisition of **Letco Medical**, a leader in nebulizer medication distribution and home diagnostic technologies (a Braff Group transaction); and **Goldman Sachs** backed **National Healthcare Staffing's** acquisition of **Nursefinders, Inc.**, a portfolio company of **Gryphon Investors**.

While overall transaction volume year to date is down from 2006 — mostly due to a 28% decrease in activity in the home medical equipment arena due to extraordinary uncertainty in reimbursement — these and other transactions suggest that the health care service merger and acquisition market is both broad-based, and strong.