

3 PERSPECTIVES

THIRD QUARTER 2009

A health care merger & acquisition quarterly review

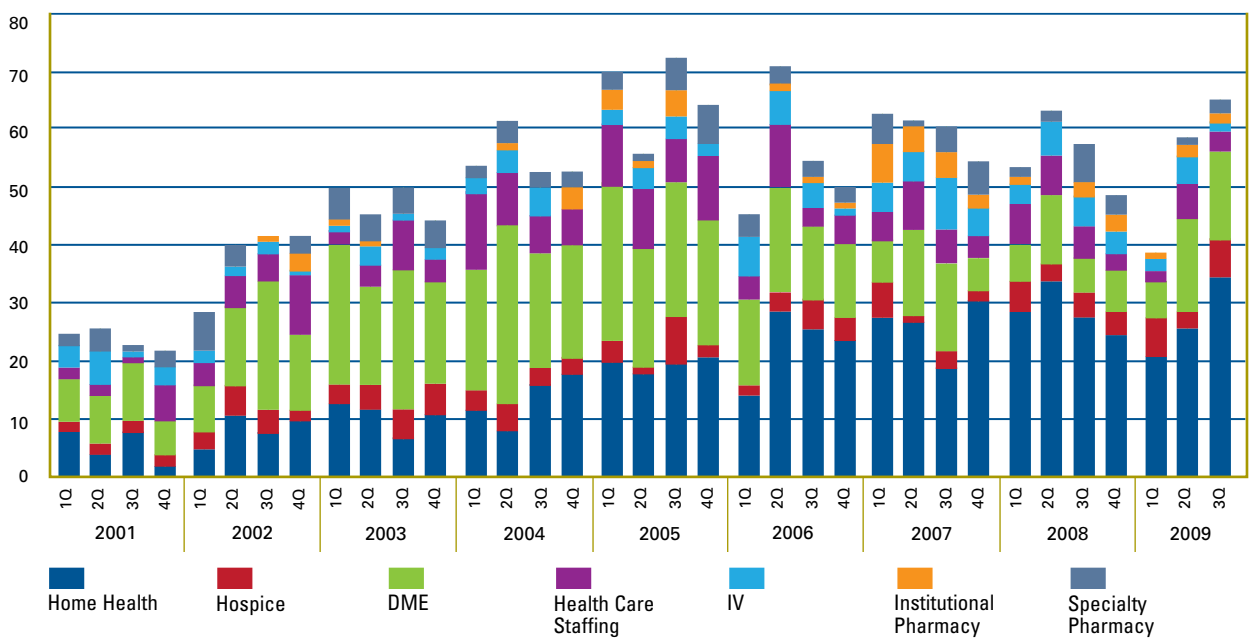


the braff group

M&A Rebound Continues as Third Quarter Deal Volume up 12% Over Q2 Highest Level Since the Second Quarter of 2006

As illustrated in **Chart 1**, after the first quarter of 2009, when deal volume was at its lowest levels in nearly seven years, merger and acquisition activity has roared back with consecutive quarterly gains of 51% and 12%, respectively. Moreover, at 66 transactions announced and/or completed during the third quarter, M&A activity reached its highest point since the second quarter of 2006.

Chart 1:
Health Care Services Deal Trends



Source: The Braff Group

Why the substantial rebound?

As we initially suggested in our second quarter issue of *Perspectives*, “While improvements in the economy helped, we suspect that while health care reform is still very much in the air, investors have rebounded from the initial shock of these potential initiatives and have been more quick to return, albeit cautiously, to sectors that, even under duress, possess extremely attractive growth and demand characteristics.”

Furthermore, we note that in such an uncertain economic and regulatory environment, buyers have been under tremendous pressure to reduce the margin for error in their deal making. As such, transactions in the current environment are under substantially greater financial and clinical scrutiny, which, in turn, has lengthened the deal cycle. Accordingly, deals that may have otherwise closed in late Q1 or Q2 may have been delayed until the third quarter, contributing, in part, to the surge in Q3 deals.

As detailed in **Table 1**, leading the way was the combined home health care sector – Medicare certified home health, state funded home health, and private duty – which recorded a record 35 transactions, largely on the strength of deal flow in the Medicare arena, which also accounted for a record 25 deals, eclipsing the previous high of 21 posted in the fourth quarter of 2007.

With 17 transactions year-to-date, the hospice sector has already equaled the record 17 deals done in all of 2003.

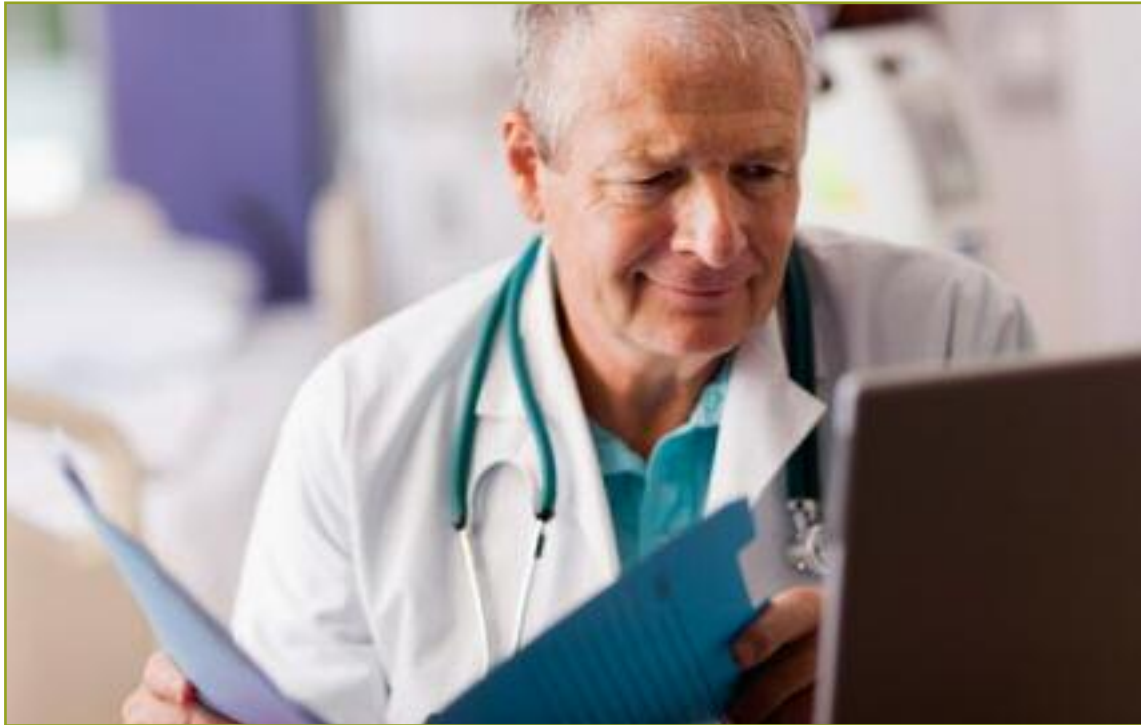
Third Quarter 2009 M&A Activity									
Sector	2nd Qtr. 2009	3rd Qtr. 2009	% Change	3rd Qtr. 2008	3rd Qtr. 2009	% Change	YTD 2008	YTD 2009	% Change
HHA-Medicare Certified	18	25	38.9%	18	25	38.9%	57	54	-5.3%
HHA-Medicaid	1	—	-100.0%	3	—	-100.0%	6	3	-50.0%
HHA-Private Duty	6	7	16.7%	6	7	16.7%	22	18	-18.2%
HHA-Other	1	3	200.0%	1	3	200.0%	7	7	0.0%
Subtotal HHA	26	35	34.6%	28	35	25.0%	92	82	-10.9%
Hospice	3	7	133.3%	4	7	75.0%	12	17	41.7%
Staffing	6	3	-50.0%	6	3	-50.0%	22	11	-50.0%
HME	16	15	-6.3%	6	15	150.0%	25	37	48.0%
Infusion Therapy	5	1	-80.0%	5	1	-80.0%	14	8	-42.9%
Institutional Pharmacy	2	2	0.0%	3	2	-33.3%	4	5	25.0%
Specialty Pharmacy	1	3	200.0%	7	3	-57.1%	11	4	-63.6%
Total	59	66	11.9%	59	66	11.9%	180	164	-8.9%

Source: The Braff Group

Also posting significant gains was the hospice sector which accounted for seven deals, its highest level since the third quarter of 2005. Furthermore, with 17 transactions year-to-date, the hospice sector has already equaled the record 17 deals done in all of 2003.

Despite the recent surge, activity levels in 2009 still lag that of last year.

For the nine months ended September 30, 2009, aggregate deal volume stood at 164 transactions, down 8.9% versus the same period last year. Perhaps, not unexpectedly, two of the largest decliners come from the Medicaid home health sub-segment and health care staffing (both down 50% year-to-date), two areas that have been particularly battered by the recession – Medicaid, in terms of funding, and staffing, in terms of severe cutbacks in utilization.



Perhaps, less intuitive are the substantial declines to-date in the infusion therapy and specialty pharmacy sectors, which are down 43% and 64% respectively. However, a deeper look at proprietary data, compiled by The Braff Group, reveals that from 2006 through the first half of 2009, private equity accounted for almost double the amount of activity in pharmacy services versus non-pharmacy M&A activity (38% vs. 21%). Accordingly, with credit markets still in turmoil, and the attendant leverage private equity relies upon to generate the financial returns it typically seeks still compromised, private equity's diminished acquisition appetite has had a disproportionately negative impact on pharmacy services. Furthermore, particularly in pharmacy services, we see a pronounced reduction of would-be sellers coming to market as they wait out both the economy (which has taken its toll on employment and hence the number of those on insurance rolls) and health care reform (which could prove beneficial to the industry as the previously uninsured access health care services). The good news is that (a) as credit opens up and private equity begins to deploy capital that has been sitting idle for more than a year now, (b) the economy improves, and (c) health care reform is settled, we anticipate a strong rebound in pharmacy services M&A activity.

In addition to the strong year-to-date activity in hospice, we note an extraordinary and continued resurgence in deal volume in the home medical equipment sector, which at 37 deals is running 41% ahead of 2008. As we indicated in our last edition of *Perspectives*, rather than being indicative of an industry resurgence, our sense is that the increased deal volume is more a result of many would-be sellers that had hoped for the elimination of competitive bidding and/or the 36 month oxygen cap (to no avail), finally, and perhaps reluctantly, coming to market.

From 2006 through the first half of 2009, private equity accounted for almost double the amount of activity in pharmacy services versus non-pharmacy M&A activity (38% vs. 21%).



The Braff Group is the leading investment banking firm specializing in the home health care, hospice, infusion therapy, specialty pharmacy, health care staffing, and home medical equipment market sectors.

The firm provides an array of transactional advisory services including sell side representation, debt and equity recapitalizations, strategic planning, and valuation.

Since being founded in 1998, The Braff Group has completed more than 150 healthcare transactions.

Near Term Outlook.

Given the timing of health care reform, the slow, but steady improvements in the economy, tax strategies, and deal cycles that typically range from 5-9 months (and are getting longer as suggested above), we foresee deal flow over the next four quarters to potentially play out as follows:

Q4.2009: As suggested above, as deal cycles have extended, the pipeline of deal flow early in the year likely swelled, prompting a surge in transactions in Q3. We should continue to see “residual closings” (albeit fewer) from this pipeline in the fourth quarter. More importantly though, with expectations that health care reform will be resolved in one form or another in the fourth quarter – legislation that could have long term impact on health care service providers – buyers and sellers alike seem content to “wait out” the final three months to the year. As such, we expect few letters of intent to be signed in the fourth quarter, and even fewer new companies coming to market during this time.

Q1.2010: On the heels of a fourth quarter where residual pipeline deals have likely already closed and buyers and sellers have adopted a wait and see attitude, we expect a substantial fall-off in closings in the beginning of 2010. But this should not be interpreted as a lack of interest. On the contrary, we anticipate that many would-be 2009 sellers will be preparing to go to market during the first quarter in order (a) to catch the post health care reform “bump” that we have been predicting (assuming legislation is passed before year end), regardless of the final language, as the fear of the unknown is eliminated, and (b) to be in position to close before 2011 when the Bush tax cuts expire and, absent congressional intervention, capital gains tax rates will rise.

Q2.2010: After two consecutive quarters with comparatively few closings, we anticipate acquisition demand should be particularly high at the same time an increasing number of companies are “in-play.” Accordingly we expect to see a ramp-up in deal volume towards the end of the second quarter.

Q3.2010: Given the dynamics of the preceding three quarters, the surge in activity that will likely begin in Q2 will likely peak in Q3. Furthermore, if credit eases steadily over the same time frame, we could see the additional impact of private equity re-entering the acquisition market. Taken together, we could very well see wide-spread, record level transaction activity in Q3.

OUR TEAM of EXPERTS

Chuck Gaetano
Atlanta
888-723-9263

Reg Blackburn
Atlanta
866-455-9198

Mark A. Kulik
Atlanta
888-922-1838

Pat Clifford
Chicago
888-922-1834

Bob Leonard
Ft. Lauderdale
888-922-1836

Steven Braff
Palm Springs
888-922-1833