

perspectives

Q4 2006: The Year in Review

A health care merger & acquisition quarterly

Home Health and IV Post Record Deal Volume in 2006 Specialty Rx Remains Strong — Other Sectors Falter

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Overview

Aggregate deal volume declines. Based upon proprietary research conducted by The Braff Group regarding merger and acquisition transaction volume, 2006 was a mixed bag for the home health care, hospice, infusion therapy, specialty pharmacy, home medical equipment, and staffing market sectors. While home health care and infusion therapy posted record results for the year (see sector specific reviews inside), substantial declines in the home medical equipment and staffing sectors contributed to an 18% plunge in aggregate deal volume — marking the first fall-off in activity since we began tracking transaction trends in 2001 (See Figure 1).

Greater breadth of acquisition activity. On a positive note however, while deal volume fell, we saw a slight increase in the number of unduplicated buyers — from 119 in 2005 to 124 in 2006. Accordingly, the average number of deals per buyer fell 21% from 2.23 in 2005 to 1.76 in

2006 — an extremely favorable trend demonstrating less concentration amongst a small group of “serial” buyers and a greater breadth of acquisition demand (see Figure 2).

The influence of “the publics” declines. Furthermore, as more private equity sponsored buyers target these sectors — particularly home health and infusion therapy — the mix of deals completed by public vs. non-publicly traded companies shifted dramatically in 2006. While in 2005, public firms accounted for 44% of all unduplicated buyers, they accounted for only 34% in 2006. Moreover, while the publics completed 68.7% of all the deals in 2005, their influence fell nearly 26% as they were responsible for only 51% of the transactions in 2006 (see Figure 2).

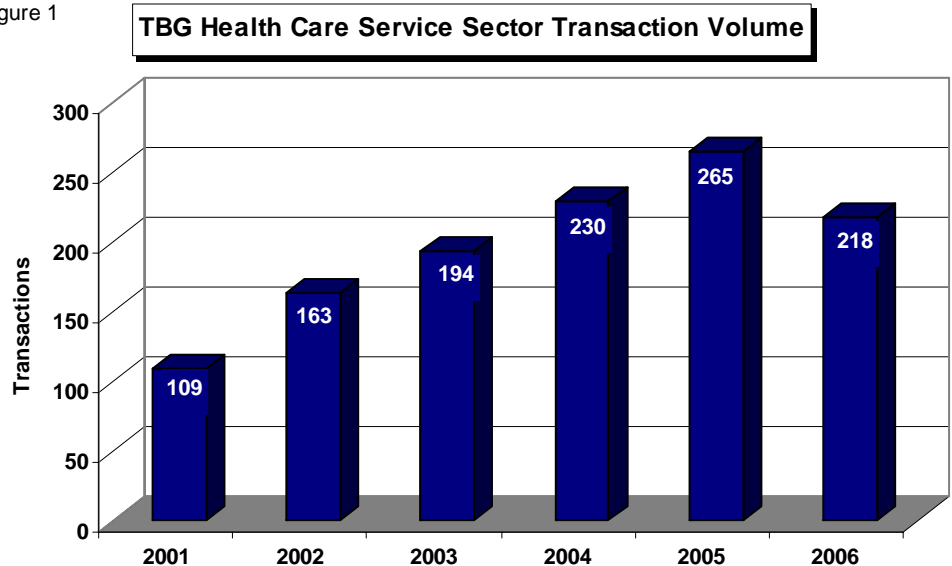
The Top 10 downsizes. Absent multiple billion dollar plus transactions completed in 2005, the total value of the top 10 transactions of the year, in terms of purchase price, dropped dramatically, from \$6 billion



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Figure 1



Source: The Braff Group

Fourth Quarter 2006: The Year in Review

"The brightest spot in 2006 was the home health care sector, which set a transaction volume record of 90 transactions, up 11% over last year's record of 81 deals"

last year to \$1.2 billion in 2006 (see Figure 3). Moreover, median deal size in the top 10 fell 74%, from \$269.4M in 2005 to \$70.8 M in 2006.

Sector Specific Review

Home Health Care. The brightest spot in 2006 was the home health care sector, which set a transaction volume record of 90 transactions, up 11% over last year's record of 81 deals. Moreover, this marks the first time that home health has led all the other sectors in transaction activity, accounting for more than 41% of all deals completed in 2006. While we are unable to identify the primary focus of every home health transaction — Medicare, Private Pay/Private Insurance, or State Funded/Medicaid — it is clear that buyers continue to largely target Medicare. This is largely due to the fact that with the recent 3.3% payment update, the sector is well positioned for a three year period of reasonably predictable reimbursement (and financial opportunity) — the update in 2007, followed by no update in 2008, and a possible cut in 2009 that can be largely offset with modifications in clinical protocols and enhanced operating efficiencies. As such, acquisition demand from

both strategic and private equity sponsored buyers remains extremely high, enabling sellers that pursue a strategically developed and orchestrated divestiture plan the opportunity to capture substantial valuation premiums (for more on this topic, see *Market Watch: Recent and Anticipated Valuation Trends for Medicare Certified Home Health Agencies*).

Though Medicare continues to capture the spotlight, **private pay** and **state funded** providers are also very much in the mix. As Medicare focused providers and buyers achieve the market penetration they are targeting, we expect (and have already seen) a steady increase in demand for private home care providers to stimulate growth, create a seamless continuum of care, and diversify payer risk. Additionally, with the Kaiser Commission on Medicaid and the Uninsured recently reporting continued **declines** in Medicaid spending growth accompanied by steady **increases** in state tax revenue growth, the outlook for Medicaid and Medicaid reimbursed home care services in particular, is as bright as we have seen in nearly ten years. Accordingly, as we enter what could be the beginning of a favorable re-

Figure 2 Merger & Acquisition Transaction Trends

Sector	Number of Deals 2005	% of Total	Number of Deals 2006	% of Total	Change
Home Health Agencies	81	30.57%	90	41.28%	11.11%
Hospice	15	5.66%	12	5.50%	-20.00%
Staffing	39	14.72%	24	11.01%	-38.46%
Home Medical Equipment	95	35.85%	57	26.15%	-40.00%
Infusion Therapy	17	6.42%	19	8.72%	11.76%
Specialty Pharmacy	18	6.79%	16	7.34%	-11.11%
Total Transactions	265	100.00%	218	100.00%	-17.74%
Unduplicated Buyers	119		124		4.20%
Transactions per Buyer	2.23		1.76		-21.05%
% Public vs. Non-Public Buyers	P 43.7% / N 56.3%		P 33.9% / N 66.1%		P -22.5% / N 17.4%
% Public vs. Non Public Deals	P 68.7% / N 31.3%		P 50.9% / N 49.1%		P -25.8% / N 56.7%

Source: The Braff Group

imbursement and utilization cycle, we expect to see large state funded providers that have largely sat on the M&A sidelines for the last four to five years reconsider and initiate regionally focused consolidation strategies (for more, see *Market Watch: Private and State Funded Home Health*).

Hospice. Although deal volume in the hospice sector declined 20% in 2006 with 12 transactions compared to 15 in 2005, a look behind the numbers reveals some favorable news. First, we note that Sunrise Senior Living's \$76M acquisition of Trinity Hospice qualified as one of the top 10 transactions of the year in terms of deal size. Second, five of the 12 deals in 2006 were completed by private equity sponsors — buyers that are extremely motivated to grow quickly through acquisition and/or startups over a traditionally short three to seven year investment horizon. Third, we note increased acquisition interest from traditional home health care providers looking to gain a foothold in the hospice arena. Given the above — and based on our experience in the market —

our read is that modest acquisition activity is being driven less by a lack of *demand*, and more by a lack of *supply*. In retrospect, this should not be a surprise as many of the comparatively few for-profit providers were acquired during the first wave of consolidation that peaked between 2002-2003. Accordingly, we believe that we are in the midst of a "re-loading" phase in which newer firms begin to reach "maturity" as potential acquisition candidates — a phase that could lead to greater deal volume over the next one to three years.

Home Infusion Therapy. 2006 was an outstanding year for M&A activity in home infusion as the sector set a new record for transaction volume with 19 deals. More importantly though, are the numbers behind the numbers. In a market with (a) comparatively stable and predictable reimbursement (compared to Medicare and Medicaid), (b) the potential for increased utilization with a revised Part D benefit, and (c) new complex therapies that require clinical intervention in development, acquisition interest in home IV is very

"In 2005, there were no home infusion therapy acquisitions completed by private equity funded companies, while in 2006, there were seven transactions completed by four private equity sponsors"

Figure 3 Top 10 Deals 2005 (a)				Top 10 Deals 2006 (a)			
Seller	Sector	Buyer	Price	Seller	Sector	Buyer	Price
Accredo Health	Specialty Rx	Medco Health Solutions	2,200,000,000	The Healthfield Group	Home Health	Gentiva	454,000,000
Priority Healthcare	Specialty Rx	Express Scripts	1,300,000,000	ICORE Healthcare	Specialty Rx	Magellan Health Services	285,000,000
TeamHealth	Staffing	The Blackstone Group	1,000,623,000	Symphony Health Services	Staffing	RehabCare Group	101,500,000
CCS Medical	Home Medical Equipment	Warburg Pincus	360,000,000	Club Staffing	Staffing	Nursefinders	78,500,000
MP TotalCare	Home Medical Equipment	Warburg Pincus	270,000,000	Trinity Hospice	Hospice	Sunrise Senior Living	76,000,000
excellRx	Specialty Rx	Omnicare	268,750,000	National Home Health Care (b,c)	Home Health	Angelo, Gordon & Co	65,600,000
RxCrossroads, LLC	Specialty Rx	Omnicare	235,000,000	World Health Alternatives	Staffing	Jackson Healthcare Staffing	53,000,000
MHA Group	Staffing	AMN Healthcare	195,000,000	Vista Staffing Solutions	Staffing	On Assignment	49,000,000
Housecall Medical	Home Health	Amedisys	106,400,000	IgG of America	Specialty Rx	AmerisourceBergen	43,500,000
PSA Pharmacy Business	Specialty Rx	Accredo / Medco	72,000,000	PSA Respiratory Therapy & Services Business	Home Medical Equipment	Lincare	35,200,000
Total Transactions			6,007,773,000				1,241,300,000
Median Deal Size			269,375,000				70,800,000

(a) Except as noted, includes only deals for which purchase prices have been made public. Price includes contingent payments. Excludes Braff Group transactions for which deal terms were not publicly announced; (b) Merger agreement; (c) Currently entertaining other offers

Source: The Braff Group

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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, and staffing market sectors. We provide merger and acquisition representation, strategic planning, and valuation services.

intelligent dealmaking

much on the rise. Consider that in 2005, with OptionCare dominating acquisition activity, the average number of deals completed per unduplicated buyer was 2.43. However, in 2006, with a more diverse group of buyers entering the market, the average number of deals per unduplicated buyer dropped to 1.58 — a positive indicator of a more expansive M&A environment. Moreover, in 2005, there were *no* acquisitions completed by private equity funded companies, while in 2006, there were *seven* transactions completed by *four* private equity sponsors. With acquisition demand for home IV being driven by a larger and broader array of strategic *and* financial buyers, the sector is extremely well positioned for a robust M&A market in 2007 (for more on Infusion Therapy and Specialty Pharmacy Services [below], see *Market Watch: Home Infusion Therapy and Specialty Pharmacy Services*).

Specialty Pharmacy Services. Though slightly off last year's volume, 2006 was another strong year for M&A activity in the specialty pharmacy services sector with 16 deals announced and/or completed. In a comparatively small and young industry, much like we observe in the hospice sector, many of the most attractive, "mature" specialty pharmacy candidates divested in the first wave of consolidations that peaked in 2003. While acquisition demand remains high, we sense that a limited supply of opportunities has likely contributed to the leveling off of activity since. However, based on our discussions with providers nationwide, we believe there are a large number of aggressive, developing firms — many of whom began to focus on specialty pharmacy in response to the surge of activity from 2001 to 2003 — that are reaching critical mass and will emerge as extremely attractive acquisition candidates over the next 1-3 years. Accordingly, we may see another ramp-up of acquisition activity in the specialty pharmacy services arena over the near to mid-term.

Home Medical Equipment. Both in raw numbers and percentage change, the home medical equipment sector posted the greatest declines in M&A activity in 2006 with 57 deals, down 38 transactions, or 40%, compared to the 95 deals completed in 2005. The decline began when a newly

conceived 36 month oxygen cap was introduced in late 2005 and was subsequently ratified in the Deficit Reduction Act passed in February this year. With the President's budget released shortly thereafter calling for ratcheting these caps further back to 13 months, and the OIG releasing its own report in September supporting such an initiative, perhaps the most interesting development in 2006 is not that transaction volume has fallen more than 40%, but that, in fact, even with the tremendous risk "*overhang*", there were still many deals completed in 2006. Although the President's 2008 budget also includes the 13 month provision, having escaped any further cutbacks when the *Tax Relief and Healthcare Act* was passed at year end, and with competitive bidding on the horizon, there is growing optimism that the industry will be otherwise "left alone" in 2007. Accordingly, while we anticipate further declines in transaction activity, in a marginally less hostile environment, these declines may be modest. In fact, we may see enough strategically select and opportunistic transactions — particularly by private equity groups and other providers pursuing "contrarian" investment strategies — that the HME arena may retain its position as the second most active M&A sector.

Health Care Staffing. A substantial 38% fall-off in acquisition activity in the health care staffing sector — 24 deals in 2006 vs. 39 in 2005 — belies the fact that there is reason to be optimistic regarding M&A prospects over the near term. According to *Staffing Industry Analysts*, the *per diem* sub-sector continues to struggle with no growth in 2006 and projections of modest growth of 1% and 2% in 2007 and 2008 respectively. Alternatively, *travel nursing* and *allied* is expected to be up 9% and 11% respectively in each of 2007 and 2008. Moreover, *locum tenens* is expected to surge 14% in 2007 and 15% in 2008. Overall then, the financial outlook for the sector is bright. Furthermore, while the raw number of deals has fallen, health care staffing made its presence felt in the M&A environment in 2006, accounting for four of the top 10 deals of the year (in terms of size), including investments from growth minded private equity sponsors. After a down year in 2006 then, we look for increased acquisition activity in 2007.